Supreme Court, U.S.
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Supreme Court of the United States

R.J. REYNOLDS TOBACCO COMPANY, *ET AL.*,

Petitioners,

v.

STATE OF MONTANA *EX REL.* STEVE BULLOCK,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Montana

PETITION FOR WRIT OF CERTIORARI

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January 29, 2010

QUESTION PRESENTED

Whether the Montana Supreme Court violated the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, by refusing to compel arbitration of a dispute that courts of 47 other States and Territories have held arbitrable under the plain terms of the nationwide Master Settlement Agreement between tobacco companies and settling States.

CORPORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, petitioners hereby state as follows:

Petitioner R. J. Reynolds Tobacco Company is a subsidiary of Reynolds American Inc., and no other publicly held company owns 10% or more of its stock.

Petitioner Philip Morris USA Inc. is a subsidiary of Altria Group, Inc., and no other publicly held company owns 10% or more of its stock.

Petitioner Lorillard Tobacco Company is a subsidiary of Lorillard, Inc., and no other publicly held company owns 10% or more of its stock.

Petitioner Commonwealth Brands, Inc. is a subsidiary of CBHC, Inc. Imperial Tobacco Group plc indirectly owns more than 10% of the stock of Commonwealth Brands, Inc.

Petitioner Compania Industrial de Tabacos Monte Paz, SA has no parent company and no publicly held company owns 10% or more of its stock.

Petitioner Daughters & Ryan has no parent company and no publicly held company owns 10% or more of its stock.

Petitioner House of Prince A/S is a subsidiary of British American Tobacco, and no other publicly held company owns 10% or more of its stock.

Petitioner Japan Tobacco International U.S.A. Inc. is a subsidiary of JT International Holding B.V. Japan Tobacco Inc. indirectly owns more than 10% of the stock of Japan Tobacco International U.S.A. Inc.

Petitioner King Maker Marketing Inc. is a subsidiary of ITC Ltd, and no other publicly held company owns 10% or more of its stock.

Petitioner Kretek International, Inc. has no parent company and no publicly held company owns 10% or more of its stock.

Petitioner Liggett Group LLC is a subsidiary of VGR Holding Inc. Vector Group Ltd. indirectly owns 10% or more of the stock of Liggett Group LLC.

Petitioner Peter Stokkebye Tobaksfabrik, A/S is a subsidiary of Orlik Tobacco Company A/S, and no other publicly held company owns 10% or more of its stock.

Petitioner Santa Fe Natural Tobacco Company is a subsidiary of Reynolds American Inc., and no other publicly held company owns 10% or more of its stock.

Petitioner Sherman's 1400 Broadway N.Y.C. Inc. is a subsidiary of Sherman Group Holdings LLC, and no publicly held company owns 10% or more of its stock.

Petitioner Top Tobacco L.P. has no parent company, and no publicly held company owns 10% or more of its stock.

Petitioner Von Eicken Group has no parent company, and no publicly held company owns 10% or more of its stock.

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INTRODUCTION

This case involves the "landmark" 1998 Master Settlement Agreement (MSA) between more than 40 tobacco companies and the governments of 46 of the 50 States, including Montana, and several Territories. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001). The MSA imposed an array of marketing and other restrictions on the settling companies, many of which could not constitutionally have been imposed by either legislation or regulation. It also required the companies to pay the States billions of dollars annually in perpetuity based on their nationwide tobacco sales—sums that the States have estimated at *$206 billion* over the first 25 years alone.

The MSA requires each settling company to make a single nationwide payment every year that is calculated and allocated by a single nationwide Independent Auditor. The MSA provides that the Auditor shall calculate and allocate such payments by starting with an agreed base and then applying various adjustments. One such adjustment reduces the settling companies' payment obligations if (1) they lose more than a specified market share to their non-settling competitors in any given year, and (2) the MSA is a "significant factor" contributing to that loss. The Agreement specifies, however, that a State may avoid its share of any such reduction by demonstrating that it has "diligently enforced" a "Qualifying Statute" imposing similar payment obligations on non-settling tobacco companies. If a State satisfies these conditions, its share of the reduction is reallocated among the other States that do not so qualify. Thus, a "diligent enforcement"

determination as to any one State directly affects the payments due to every other State.

Given the obvious potential for disputes over this payment and allocation scheme, and the need for uniform nationwide resolution of such disputes, the MSA includes a broad arbitration provision requiring arbitration of such disputes by a panel of three former federal judges. In relevant part, the provision requires arbitration of "[a]ny dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor," specifically including "the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations" described in the Agreement. The provision further confirms that the Federal Arbitration Act (FAA) shall govern any such arbitration.

This dispute arises out of the settling companies' request for a reduction, totaling more than *$1.1 billion*, in their payments for 2003. In that year, the settling companies lost more than the requisite market share to their non-settling competitors, and a Nobel-laureate economist jointly selected by the parties determined that the MSA was a "significant factor" contributing to that loss. Under these circumstances, the MSA provides that an adjustment "shall apply," and directs the Auditor to allocate that adjustment among the States.

At the urging of the States, however, the Auditor denied the adjustment on the ground that each State had enacted a "Qualifying Statute" and should be *presumed* to have "diligently enforced" it. As a consequence, the Auditor determined that the

companies were not entitled to any payment reduction for 2003.

The companies challenged the Auditor's determination and sought to arbitrate the "diligent enforcement" issue pursuant to the MSA's arbitration provision. Each of the 46 settling States (plus the District of Columbia and Puerto Rico), however, refused to arbitrate, asserting that this issue falls outside the MSA's arbitration provision and thus must be litigated separately in the courts of each State. Courts in 47 of the 48 affected jurisdictions rejected this position, holding that the plain language of the MSA requires arbitration of the "diligent enforcement" issue, along with all other issues related to the Auditor's decision to deny the NPM Adjustment.

The decision below is the lone outlier: a divided Montana Supreme Court held that a determination of "diligent enforcement" under the MSA does not fall within the scope of the MSA's arbitration provision, and thus must be resolved in court. That holding—rendered *after* the courts of 47 other jurisdictions, including 20 appellate courts, held that this dispute *does* fall within the scope of the MSA's arbitration provision—turns the FAA on its head. That statute requires both federal and state courts to enforce arbitration provisions according to their terms, and establishes a substantive federal policy in *favor* of arbitration. Here, as underscored by the lopsided conflict between the Montana Supreme Court and the courts of *every other jurisdiction in the Nation* to have decided this precise issue, a dispute over "diligent enforcement" under the MSA clearly falls within the plain language of the MSA's broad

arbitration provision. And this conflict arises under *federal*, not *state*, law: where, as here, a dispute falls within the plain terms of an arbitration provision, the FAA requires a court to enforce that provision. If the federal substantive policy favoring arbitration means anything, it means that state courts are not free to interpret arbitration provisions as they please, but must enforce such provisions by their terms and resolve any doubts in favor of arbitrability. By refusing to do so here, notwithstanding the contrary rulings of the other 47 jurisdictions to have addressed this precise issue, the Montana Supreme Court flouted federal law.

This petition calls upon this Court to vindicate the integrity and supremacy of federal law. Given that the courts of 47 other jurisdictions have concluded that the very dispute at issue here is subject to arbitration, it is hard to imagine a better vehicle for reminding the Montana Supreme Court—which, in recent years, has effectively rendered that State an "arbitration free" zone—of its obligations under federal law. And the arbitration issue presented here is particularly consequential, because the decision below undercuts a landmark agreement between the Nation's major tobacco companies (and many smaller companies) and virtually every State and Territory involving the payment and allocation of billions of dollars and the imposition of historic restrictions on tobacco marketing and advertising. If ever there were a case in which it is imperative for this Court to ensure compliance with the FAA, this is it. Accordingly, petitioners respectfully request that this Court grant the petition and either summarily reverse the decision below or set this case for plenary consideration.

OPINIONS BELOW

The Montana Supreme Court's decision is reported at 217 P.3d 475 and 352 Mont. 30, and reprinted in the Appendix ("App.") at 1-27a. The Montana Supreme Court's unreported order denying rehearing is reprinted at App. 28-31a. The Montana district court's unreported decision is reprinted at App. 32-40a.

JURISDICTION

The Montana Supreme Court rendered its decision on August 5, 2009, App. 1a, and denied a timely petition for rehearing on September 10, 2009, App. 28a. On December 2, 2009, Justice Kennedy extended the time within which to file this petition until February 5, 2010. Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1257(a).

PERTINENT STATUTORY AND CONTRACTUAL PROVISIONS

Section 2 of the Federal Arbitration Act provides in pertinent part:

> A written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

The Master Settlement Agreement provides in relevant part:

> **Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.**
>
> (A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.
>
> (B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.
>
> ***
>
> (E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule ... that effectively and fully neutralizes the cost disadvantages that the Participating

> Manufacturers experience vis-à-vis Non Participating Manufacturers within such Settling State as a result of the provisions of [the Master Settlement Agreement].

Master Settlement Agreement § IX(d)(2).

> **Order of Application of Allocations, Offsets, Reductions and Adjustments**. The payments under this Agreement shall be calculated as set forth below.
>
> ***
>
> *Sixth*: the NPM Adjustment shall be applied ... pursuant to subsections IX(d)(1) and (d)(2)....

Master Settlement Agreement § IX(j).

> **Resolution of Disputes.** Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge .... The arbitration shall be governed by the United States Federal Arbitration Act.

Master Settlement Agreement § XI(c).

STATEMENT OF THE CASE

A. Background

The MSA resolved one of the major public policy controversies of the past generation: the responsibility of tobacco companies for health care costs that have been associated with smoking. Instead of litigating that issue in court, the settling States and tobacco companies chose to resolve their differences through the MSA. Under that Agreement, the settling States released their claims against the settling companies (the Participating Manufacturers or PMs), and the PMs in return agreed to make substantial annual payments in perpetuity based upon their nationwide cigarette sales (MSA § IX), and to abide by a variety of marketing restrictions and other obligations (MSA §§ III-VI).[1]

Under the MSA, a single nationwide Independent Auditor determines the PMs' yearly nationwide payment obligations and allocates those payments among the settling States using previously determined "Allocable Shares." MSA § II(f). PMs do not owe any individual State any specific amount of money, and do not make payments to individual States. Rather, each PM makes a single, nationwide payment that the Auditor then allocates among the States. MSA §§ IX(a), (c).

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[1] The entire MSA is available online at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf/1109185724_1032468605_cigmsa.pdf.

Because the obligations imposed on the PMs put them at a disadvantage with respect to their non-settling competitors, the MSA includes a mechanism to reduce the PMs' payment obligations if (1) the PMs lose a specified market share to non-settling companies (Non-Participating Manufacturers or NPMs) in any given year, and (2) the PMs' obligations under the MSA are a "significant factor" contributing to that loss. MSA § IX(d), (j).

The Agreement further provides that a State may avoid the allocation of any such reduction (or "NPM Adjustment") to its annual payment by enacting and "diligently enforcing" a "Qualifying Statute" imposing obligations upon NPMs that are similar to those the MSA places on PMs. MSA § IX(d)(2)(B). If a State demonstrates that it enacted and "diligently enforced" a Qualifying Statute, the Auditor must reallocate that State's share of the NPM Adjustment among other States that do not so demonstrate. MSA § IX(d)(2)(C). Thus, a "diligent enforcement" determination as to any one State directly impacts the annual payments received by every other State.

Section XI(a)(1) of the MSA provides that the Auditor shall make all calculations and determinations necessary to determine the payments due under the MSA, including the amount of any adjustments and their allocation among PMs and settling States. MSA § XI(a)(1). Section IX(j), in turn, specifies the manner in which payments "shall be calculated," including thirteen specific steps the Auditor must follow in applying various offsets, reductions, and adjustments to the base payment. MSA § IX(j). The sixth step in this calculation specifies that the "NPM Adjustment shall be applied

... pursuant to subsections IX(d)(1) and (d)(2) ...." *Id.* Section IX(d)(1), in turn, sets forth the conditions for application of the NPM Adjustment, and § IX(d)(2) sets forth how that Adjustment must be allocated according to which States enacted and "diligently enforced" Qualifying Statutes. The Auditor is therefore required to determine with respect to each annual payment whether the NPM Adjustment applies, and, if so, how it is to be allocated among the States. *See* MSA §§ IX(d)(1), XI.

Consistent with the MSA's imposition of a single, nationwide payment obligation, the Agreement requires that "[a]ny dispute, controversy or claim arising out of or relating to" the Auditor's calculations and determinations—specifically including "any dispute concerning the operation or application" of the adjustments and allocations—"shall be submitted to binding arbitration" before a panel of three former federal judges:

> (c) **Resolution of Disputes**. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge.

MSA § XI(c). Although the FAA on its face governs the enforcement of this provision—the MSA is self-

evidently "a contract evidencing a transaction involving commerce," 9 U.S.C. § 2—the parties underscored their intention to be bound by the FAA by specifying in the Agreement that "[t]he arbitration shall be governed by the United States Federal Arbitration Act." MSA § XI(c).

B. Procedural History

This dispute arises out of the Auditor's refusal to apply an NPM Adjustment to the PMs' annual payments to reflect a loss of market share to NPMs in 2003. In March 2004, the Auditor found that the PMs had lost more than the requisite market share to the NPMs, and in March 2006, an independent economic consulting firm jointly selected by the parties (Brattle Group and Nobel laureate Daniel McFadden) found that the MSA was a "significant factor" contributing to that loss. Because the MSA provides that the Auditor "shall apply" the NPM Adjustment when these conditions are satisfied, MSA § IX(d)(1)(C), the PMs formally requested such an adjustment (worth approximately $1.1 billion) to their next annual payment, due in April 2006.

In response, Montana and the other States urged the Auditor to reject the PMs' request on the ground that the Auditor should simply *presume* that each State had "diligently enforced" a Qualifying Statute. Over the PMs' objection, the Auditor agreed.

The PMs demanded arbitration of the parties' dispute concerning the applicability and allocation of the 2003 NPM Adjustment, including the "diligent enforcement" issue. Each of the 46 States that are parties to the MSA (as well as the District of Columbia and Puerto Rico), however, took the position that "diligent enforcement" fell outside the

MSA's arbitration provision and must be litigated in its individual state courts rather than the nationwide arbitration. The PMs moved to compel arbitration in each of these States and Territories, including Montana.

The courts of 47 of these 48 jurisdictions, including 20 appellate courts, agreed with the PMs that any dispute over "diligent enforcement" is subject to arbitration under the MSA. So did the Montana district court, which granted the PMs' motion to compel arbitration. *See* App. 32-40a. As that court explained, a dispute over "diligent enforcement" necessarily "arises out of or relates to" the Auditor's payment "determinations" and "calculations." App. 39-40a. In particular, "the issue of whether 'diligent enforcement' has occurred is necessarily linked to whether the NPM Adjustment applies," which in turn is "one of the major adjustments the Auditor is to determine under the MSA." App. 39a. And the arbitration clause further confirms that point by specifically requiring arbitration of all disputes arising out of or relating to "the operation or application" of "the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j)," which in turn provides for the NPM Adjustment, including its allocation to States that do not demonstrate "diligent enforcement" of a "Qualifying Statute." App. 38-39a. Thus, the Montana district court concluded, "it is clear that the current dispute concerning the Auditor's determination not to apply the 2003 NPM Adjustment ... is a matter for arbitration." App. 39a.

Without hearing oral argument, a divided Montana Supreme Court reversed. The majority

held that the MSA requires arbitration "only" of determinations "actually 'performed' or 'made'" by the Auditor. App. 12-16a; *see also* App. 16-17a ("When the arbitration provision is read as a whole, it is clear that the parties intended to arbitrate *only* those disputes which involve calculations performed or determinations made by the Independent Auditor.") (emphasis added). The majority did not reconcile this interpretation with the MSA's plain language, which requires arbitration not only of disputes concerning the Auditor's "determinations" and "calculations," but also those "arising out of or relating to" such determinations and calculations, "including without limitation any disputes concerning the operation or application of any of" the MSA's "adjustments" and "allocations." Although all 47 other jurisdictions to address this dispute had interpreted this precise language to require arbitration of this precise dispute by the time the Montana Supreme Court ruled, the majority summarily dismissed those decisions on the ground that this was purely an issue of Montana law. The majority did not address the FAA, or the PMs' argument that the plain language of the arbitration provision required arbitration as a matter of *federal* law.

Justice Rice dissented. *See* App. 21-27a. He first criticized the majority for "ignor[ing]" this Court's FAA decisions, "which concretely establish an approach strongly favoring arbitration." App. 21a (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985)); *see also id.* ("The decision in this case should not be made without consideration of the federal ... polic[y] favoring arbitration."). Turning to the MSA's

language, Justice Rice noted that the MSA's arbitration clause is not limited to appeals of determinations "actually 'performed' or 'made'" by the Auditor. Rather, the MSA requires arbitration of any matter "arising out of or relating to" such determinations. App. 22-26a. Justice Rice observed that this was a "critical phrase" that had been "interpreted nationally" to require arbitration of the dispute here because a State's claim of "diligent enforcement" was inextricably "related to" the Auditor's refusal to apply the 2003 NPM Adjustment. App. 24-25a. Justice Rice further observed that "the arbitration provision incorporates by reference [to subsection IX(j)] the very provisions out of which the dispute in this case arises," because "[s]ubsection IX(j) provides that 'the NPM Adjustment shall be applied ... pursuant to subsections IX(d)(1) and (d)(2),' and, in turn, subsection IX(d)(2) is the provision which establishes 'diligent enforcement' and the Settling States' exemption." App. 23a.

Petitioners sought rehearing, and again emphasized the FAA's substantive federal presumption in favor of arbitration. The Montana Supreme Court denied the petition without responding to (or even acknowledging) petitioners' federal arguments. App. 28-31a.

This petition follows.

REASON FOR GRANTING THE WRIT

The Montana Supreme Court Violated The Federal Arbitration Act By Refusing To Compel Arbitration Of A Dispute That Courts Of 47 Other Jurisdictions Have Held Arbitrable Under The Plain Terms Of The Nationwide Tobacco Litigation Master Settlement Agreement.

This petition concerns the integrity and supremacy of federal law. The FAA establishes a substantive federal policy in favor of arbitration, which requires both federal and state courts to enforce arbitration agreements according to their terms, and to resolve any doubts in *favor* of arbitration. *See, e.g.*, *Preston v. Ferrer*, 128 S. Ct. 978, 981, 983 & n.2 (2008); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443-45 (2006); *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 688 (1996); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270 (1995); *Mitsubishi*, 473 U.S. at 625-26; *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). The decision below squarely conflicts with this federal law, and with the decisions of the other 47 jurisdictions that have addressed the precise issue presented here. And it is hard to overstate the practical implications of that decision, which concerns the operation of a landmark nationwide agreement involving the payment and allocation of *billions* of dollars annually. If a state court can disregard federal arbitration law with respect to this landmark nationwide agreement, then a state court

can disregard federal arbitration law with respect to any agreement. Indeed, this decision is only the latest in an ongoing series of decisions by the Montana Supreme Court that, for all intents and purposes, has rendered the FAA a dead letter in that State.

The FAA provides that, as a matter of *federal* law, an arbitration provision in any contract involving commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Thus, while "the interpretation of private contracts is ordinarily a question of state law," *Volt Info. Scis., Inc. v. Board of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 474 (1989), the interpretation of an arbitration agreement is ultimately "a question of substantive federal law," *Southland*, 465 U.S. at 12; *see also Moses H. Cone*, 460 U.S. at 24 (federal law "governs" the "arbitrability of the dispute" under the FAA).

The FAA thus imposes several substantive federal constraints on courts called upon to interpret and enforce arbitration provisions. *First*, it "requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 478; *see also id.* at 476 ("[T]he federal policy is ... to ensure the enforceability, according to their terms, of private agreements to arbitrate."); *id.* at 485-87 (Brennan, J., dissenting) (agreeing with the Court that the interpretation of an arbitration agreement "raise[s] a question of federal law"). *Second*, it requires that any "ambiguities as to the scope of the arbitration clause itself [be] resolved in favor of arbitration."

Mastrobuono, 514 U.S. at 62 (internal quotation omitted). And *third*, it preempts the operation of state law that would thwart the operation of this federal substantive law of arbitrability. *See, e.g.*, *Mastrobuono*, 514 U.S. at 58 ("[T]he FAA ensures that [an arbitration] agreement will be enforced according to its terms *even if a rule of state law would otherwise exclude such claims from arbitration.*") (emphasis added); *see also Preston*, 128 S. Ct. at 982-89 (reversing state court decision invoking state law to deny arbitration); *Buckeye*, 546 U.S. at 443-49 (same); *Casarotto*, 517 U.S. at 683-88 (same).

Indeed, the FAA's federal substantive policy favoring arbitration *presupposes* that courts will enforce arbitration clauses according to their terms: because the statute requires courts to compel arbitration if there is even "doubt" on that score, *see, e.g.*, *Mitsubishi*, 473 U.S. at 626; *Moses H. Cone*, 460 U.S. at 24-25, it follows *a fortiori* that the statute requires courts to compel arbitration where (as here) there is no such doubt. The whole point of the statute, after all, is to overcome the traditional judicial hostility to arbitration by requiring courts to enforce arbitration provisions according to their terms. *See, e.g.*, *Volt*, 489 U.S. at 478-79; *Southland*, 465 U.S. at 10-16. If courts were free to thwart arbitration by giving arbitration provisions an artificially narrow interpretation under state law, the FAA would be entirely hortatory. This Court has not hesitated to grant review where state courts (including the Montana Supreme Court) have applied state law in a way that thwarts federal arbitration rights. *See, e.g.*, *Preston*, 128 S. Ct. at

982-89; *Buckeye*, 546 U.S. at 443-49; *Casarotto*, 517 U.S. at 683-88.

In this case, the Montana Supreme Court refused to apply the federal substantive law of arbitrability—or even to acknowledge its existence. By its plain terms, the MSA's arbitration provision requires arbitration of "[a]ny dispute, controversy or claim arising out of *or relating to* calculations performed by, or any determinations made by, the Independent Auditor." MSA § XI(c) (emphasis added). The Montana Supreme Court simply excised the italicized words from the MSA, and thereby converted a broad arbitration clause into a narrow one. *See, e.g.*, App. 24a (Rice, J., dissenting) (noting that the "related to" language makes this the "'paradigm of a broad clause'" and "'constitutes the broadest language the parties could reasonably use.'") (quoting *Fleet Tire Serv. of N. Little Rock v. Oliver Rubber Co.*, 118 F.3d 619, 621 (8th Cir. 1997), and citing *Collins & Aikman Prods. Co. v. Building Sys., Inc.*, 58 F.3d 16, 20 (2d Cir. 1995)). In addition, the Montana Supreme Court refused to give effect to the plain language specifying that "any dispute concerning the operation of any of the adjustments, reductions, offsets, carry-forwards, and allocations"—including the NPM Adjustment—*are* "related to" the Auditor's "calculations" and "determinations." MSA § XI(c).

Not surprisingly, until the decision below, the courts of *every other jurisdiction in the Nation* to have addressed this precise issue had held otherwise. Thus, Justice Rice opened his dissent by noting that "[c]ourts in 48 states, including the [Montana district court]" had "unanimously concluded" that the MSA

requires arbitration of disputes, like this one, over "diligent enforcement" under the MSA, along with all other issues related to the Auditor's determination to deny the NPM Adjustment. App. 21a. To wit:

Alabama: *Alabama v. Lorillard Tobacco Co.*, 1 So.3d 1 (Ala. 2008);

Alaska: *Alaska v. Philip Morris Inc.*, No. 1JU-97-915 CI, 2007 WL 6561051 (Alaska Super. Ct. Feb. 5, 2007);

Arizona: *Arizona v. Philip Morris Inc.*, No. 1CA-SA 07-0083 (Ariz. Ct. App. May 24, 2007);

Arkansas: *Arkansas v. American Tobacco Co.*, No. IJ1997-2982, 2006 WL 5400237 (Ark. Cir. Ct. Nov. 29, 2006), *pet. denied*, No. 07-17 (Ark. 2007);

California: *In re Tobacco Cases*, No. JCCP 4041 (Cal. Super. Ct. Aug. 23, 2006), *pet. denied*, No. JCCP 4041 (Cal. Ct. App. Dec. 5, 2006);

Colorado: *Colorado v. R.J. Reynolds Tobacco Co.*, No. 97 CV 3432 (Colo. Dist. Ct. July 19, 2006);

Connecticut: *Connecticut v. Philip Morris, Inc.*, 905 A.2d 42 (Conn. 2006);

Delaware: *Delaware v. Philip Morris USA, Inc.*, No. 657, 2006, 2007 WL 1138472 (Del. Apr. 17, 2007);

District of Columbia: *District of Columbia v. Philip Morris USA, Inc.*, No. 2006 CA 003176 B, 2006 WL 6273143 (D.C. Super. Ct. Sept. 26, 2006);

Georgia: *Georgia v. Philip Morris USA, Inc.*, No. 2006CV116128 (Ga. Super. Ct. Feb. 4, 2008);

Hawaii: *Hawaii v. Philip Morris USA*, No. 06-1-0695-04 KSSA (Haw. Cir. Ct. Aug. 2, 2006);

Idaho: *Idaho v. Philip Morris, Inc.*, No. CV OC 97 03239D, 2006 WL 5400238 (Idaho Dist. Ct. June 30, 2006), *leave to appeal denied*, No. 99567 (Idaho 2006);

Illinois: *Illinois v. Lorillard Tobacco Co.*, 865 N.E.2d 546 (Ill. App. Ct.), *appeal denied*, 875 N.E.2d 1119 (Ill. 2007);

Indiana: *Indiana v. Philip Morris Tobacco Co.*, 879 N.E.2d 1212 (Ind. Ct. App.), *transfer denied*, 898 N.E.2d 1217 (Ind. 2008);

Iowa: *Iowa v. Philip Morris USA, Inc.*, No. CL 71048, 2006 WL 5345156 (Iowa Dist. Ct. Aug. 16, 2006), *appeal dismissed*, No. 06-1486 (Iowa Feb. 16, 2007);

Kansas: *Kansas v. R.J. Reynolds Tobacco Co.*, No. 96-CV-919, 2007 WL 5416536 (Kan. Dist. Ct. July 9, 2007);

Kentucky: *Kentucky v. Brown & Williamson Tobacco Corp.*, 244 S.W.3d 116 (Ky. Ct. App. 2007), *review denied*, No. 2007-SC-0893-D (Ky. Feb. 13, 2008);

Louisiana: *Louisiana v. Philip Morris, USA, Inc.*, 982 So.2d 296 (La. Ct. App.), *writ denied*, 992 So.2d 942 (La. 2008);

Maine: *Maine v. Philip Morris, Inc.*, 928 A.2d 782 (Me. 2007);

Maryland: *Maryland v. Philip Morris Inc.*, 944 A.2d 1167 (Md. Ct. Spec. App.), *cert. denied*, 949 A.2d 653 (Md. 2008);

Massachusetts: *Massachusetts v. Philip Morris Inc.*, 864 N.E.2d 505 (Mass. 2007);

Michigan: *Michigan v. Philip Morris USA, Inc.*, No. 273665, 2007 WL 1651839 (Mich. Ct. App. June 7, 2007), *appeal denied*, 742 N.W.2d 118 (Mich. 2007);

Missouri: *Missouri v. American Tobacco Co.*, Inc., No. 22972-01465, 2007 WL 6509213 (Mo. Cir. Ct. Jan. 22, 2007);

Nebraska: *Nebraska v. R.J. Reynolds Tobacco Co.*, 746 N.W.2d 672 (Neb. 2008);

Nevada: *Nevada v. Philip Morris USA*, 199 P.3d 828 (Nev. 2009);

New Hampshire: *New Hampshire v. Philip Morris USA, Inc.*, 927 A.2d 503 (N.H. 2007);

New Jersey: *New Jersey v. Philip Morris USA, Inc.*, No. C-103-06, 2006 WL 6000399 (N.J. Super. Ct. 2006), *appeal denied*, No. 62,087 (N.J. Super. Ct. App. Div. Dec. 4, 2007);

New Mexico: *New Mexico v. American Tobacco Co.*, 194 P.3d 749 (N.M. Ct. App. 2008);

New York: *New York v. Philip Morris Inc.*, 838 N.Y.S.2d 460 (N.Y. 2007);

North Carolina: *North Carolina v. Philip Morris USA, Inc.*, 666 S.E.2d 783 (N.C. Ct. App. 2008), *writ denied*, 676 S.E.2d 54 (N.C. 2009);

North Dakota: *North Dakota v. Philip Morris, Inc.*, 732 N.W.2d 720 (N.D. 2007);

Ohio: *Ohio v. Philip Morris, Inc.*, No. 06AP-1012, 2008 WL 2854536 (Ohio Ct. App. July 24, 2008), *leave to appeal denied*, 898 N.E.2d 969 (Ohio 2008);

Oklahoma: *Oklahoma v. R.J. Reynolds Tobacco Co.*, No. CJ-96-1499, 2007 WL 6509215 (Okla. Dist. Ct. Jan. 29, 2007), *appeal dismissed*, No. 104,518 (Okla. 2007);

Oregon: *Oregon v. Philip Morris USA*, No. 0604-04252, 2006 WL 6273150 (Or. Cir. Ct. Aug. 29, 2006);

Pennsylvania: *Pennsylvania v. Philip Morris USA, Inc.*, No. 2443, 2006 WL 6288185 (Pa. Ct. Com. Pl. Dec. 12, 2006), *appeal denied*, 951 A.2d 265 (Pa. 2008);

Puerto Rico: *Puerto Rico v. Brown & Williamson*, No. 97-1910, 2007 WL 2844272 (D.P.R. Sept. 26, 2007);

Rhode Island: *Rhode Island v. Brown & Williamson Tobacco Corp.*, No. 97-3058, 2007 WL 1100077 (R.I. Super. Ct. Mar. 27, 2007);

South Carolina: *South Carolina v. Brown & Williamson Tobacco Corp.*, No. 97-CP-40-1686 (S.C. Ct. Com. Pl. Apr. 27, 2007);

South Dakota: *South Dakota v. R.J. Reynolds Tobacco Co.*, No. 06-161, 2006 WL 6273153 (S.D. Cir. Ct. Oct. 2, 2006), *appeal dismissed*, No. 24311 (S.D. Jan. 5, 2007);

Tennessee: *Tennessee v. Brown & Williamson Tobacco Corp.*, No. 98-3776-1, 2006 WL 5345521 (Tenn. Ch. Ct. Dec. 7, 2006), *leave to appeal denied*, No. M2007-00476-COA-R9-CV (Tenn. Ct. App. Mar. 16, 2007);

Utah: *Utah v. R.J. Reynolds Tobacco Co.*, No. 2:96-CV-0829 (Utah Dist. Ct. Dec. 15, 2006);

Vermont: *Vermont v. Philip Morris USA Inc.*, 945 A.2d 887 (Vt. 2008);

Virginia: *Virginia v. Brown & Williamson Tobacco Corp.*, No. HJ-2241, 2006 WL 6273154 (Va. Cir. Ct. Aug. 9, 2006), *leave to appeal denied*, No. 062245 (Va. Feb. 21, 2007);

Washington: *Washington v. Philip Morris USA*, No. 06-2-13262-9SEA, 2006 WL 6273155 (Wash. Super. Ct. Sept. 28, 2006), *appeal dismissed*, No. 59036-7-1, slip op. (Wash. Ct. App. Feb. 21, 2007);

West Virginia: *West Virginia v. American Tobacco Co.*, 681 S.E.2d 96 (W. Va. 2009);

Wisconsin: *Wisconsin v. Philip Morris Inc.*, No. 97-CV-0328, 2007 WL 6509259(Wis. Cir. Ct. Mar. 14, 2007);

Wyoming: *Wyoming v. Philip Morris USA Inc.*, No. 26718 (Wyo. Dist. Ct. Jan. 8, 2007).

The Montana Supreme Court majority shrugged off this unbroken line of authority as "not binding" and of "limited persuasive value." App. 19a. That is so, the majority declared, because "we are applying Montana law to the particular claims raised by the State in its motion for declaratory order." *Id.*; *see also* App. 17a ("[O]ur decision must be based on Montana law ...."); App. 29a ("[W]e are applying Montana's contract law to determine whether the parties agreed to arbitrate the present dispute."). The majority did not, and could not, explain *what* it is about "Montana law" that provides for a result different from that reached by every other court, or

how it could, consistent with the FAA, apply "Montana law" to override the plain terms of an arbitration agreement. Nor could or did the majority explain how its interpretation of the MSA's arbitration provision comported with the *federal* presumption in favor of arbitration. Indeed, the majority opinion below is written as if the FAA did not exist.

In particular, the Montana Supreme Court majority held that the MSA's arbitration provision applies *only* to challenges to the Auditor's specific "calculations" and "determinations." App. 12-16a. According to the majority, reading that provision to encompass any other disputes would "effectively nullify the limiting words 'calculations performed by, or any determinations made by' the Independent Auditor." App. 16a.

But, as every other court has recognized, that is a *non sequitur*. The whole point of the "related to" language is to extend the arbitration provision to disputes *beyond* those specifically challenging particular "calculations" or "determinations." A dispute over "diligent enforcement" necessarily "relates to" the Auditor's "calculations" and "determinations"; indeed, under the MSA, those are the *only* things to which "diligent enforcement" relates. *See* MSA § IX(d)(2)(B); *see also North Carolina*, 666 S.E.2d at 792-93; *Alabama*, 1 So.3d at 10; *Maryland*, 944 A.2d at 1176-78; *Indiana*, 879 N.E.2d at 1218; *New Hampshire*, 927 A.2d at 512; *Massachusetts*, 864 N.E.2d at 513.

Moreover, as other courts have again confirmed, the MSA underscores this broad arbitration requirement with language *specifically*

encompassing "any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j)." MSA § XI(c). Subsection IX(j), in turn, specifies that the "the NPM Adjustment shall be applied ... pursuant to subsections IX(d)(1) and (d)(2)" in "calculat[ing]" the "payments due under this Agreement." MSA § IX(j). And subsection IX(d)(2) specifies that a State may avoid allocation of the NPM Adjustment by demonstrating that it has "diligently enforced" a Qualifying Statute. MSA § IX(d)(2). Accordingly, the MSA's arbitration provision *on its face* makes clear that a dispute concerning "diligent enforcement," along with all other disputes related to the Auditor's decision to deny the NPM Adjustment, is subject to arbitration. *See, e.g.*, *North Carolina*, 666 S.E.2d at 792; *New Mexico*, 194 P.3d at 754; *Louisiana*, 982 So.2d at 300; *Alabama*, 1 So.3d at 12; *Maryland*, 944 A.2d at 1177.

That is why the courts of the other 47 States and Territories to have addressed this precise issue have concluded that a dispute over "diligent enforcement" falls "clearly within the [MSA's] arbitration provision." *Connecticut*, 905 A.2d at 51; *see also Nevada*, 199 P.3d at 833 ("[U]nder the arbitration clause's clear language, disputes regarding diligent enforcement are subject to arbitration ...."); *Nebraska*, 746 N.W.2d at 680 ("[A] dispute regarding diligent enforcement is a dispute 'relating to' the independent auditor's calculations and therefore a dispute subject to arbitration."); *Alabama*, 1 So.3d at 8 ("[T]he clear and unambiguous language of the arbitration provision compels arbitration ...."); *Illinois*, 865 N.E.2d at 554 ("[T]he plain and unambiguous language of the MSA's arbitration

provision requires arbitration ...."); *Louisiana*, 982 So.2d at 300 (arbitration required "[i]n light of the clear and explicit language of Subsection XI(c)"); *Maryland*, 944 A.2d at 1175 ("MSA § XI(c) unambiguously requires arbitration."); *New Hampshire*, 927 A.2d at 514 ("[T]his dispute [over "diligent enforcement"] falls squarely under the arbitration provision of the MSA."); *Massachusetts*, 864 N.E.2d at 512 ("The language of the settlement agreement arbitration clause ... plainly and unambiguously encompasses the present dispute."); *New York*, 869 N.E.2d at 463 ("The plain language of the MSA compels arbitration."); *North Dakota*, 732 N.W.2d at 731 ("[T]he plain and unambiguous language of the settlement agreement requires arbitration of the parties' dispute ...."); *Vermont*, 945 A.2d at 895 (denying arbitration would be "contrary to both the [MSA's] spirit and the plain language"); *West Virginia*, 681 S.E.2d at 112 ("The plain and unambiguous terms and structure of the Master Settlement Agreement provide for arbitration of a diligent enforcement determination in a single, unitary proceeding involving all participants to the Master Settlement Agreement ...."). In particular, contrary to the Montana Supreme Court's assertion, "'there is nothing in the arbitration clause limiting arbitration to those questions actually determined'" by the Auditor. *North Dakota*, 732 N.W.2d at 728 (quoting *Massachusetts*, 864 N.E.2d at 513); *see also Alabama*, 1 So.3d at 10-11; *Illinois*, 865 N.E.2d at 553.

By refusing to enforce the MSA's arbitration provision according to its plain terms, the Montana Supreme Court deprived the parties of their federal arbitration rights. If this Court's repeated

admonition that "as a matter of *federal* law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration," *Mitsubishi*, 473 U.S. at 626 (emphasis added), means anything, it means that this dispute is arbitrable as a matter of federal law. *See, e.g.*, *Alabama*, 1 So.3d at 7 (invoking the FAA in holding this dispute arbitrable); *Louisiana*, 982 So.2d at 301 (same); *Massachusetts*, 864 N.E.2d at 511 (same); *Maryland*, 944 A.2d at 1181-82 (same).

While a state court's refusal to enforce federal rights is troubling in any context, the Montana Supreme Court's refusal to enforce federal arbitration rights is particularly problematic in the context of a "landmark" agreement of "national effect and structure" like the MSA. *Reilly*, 533 U.S. at 533; *Indiana*, 879 N.E.2d at 1220; *see also West Virginia*, 681 S.E.2d at 109-12. In light of its nationwide payment structure, the MSA's payment provisions were designed to operate in a cohesive nationwide manner. Thus, "the agreement's broad referral to an arbitration panel of '[a]ny dispute, controversy or claim arising out of [or relating to]' the independent auditor's calculations or determinations reflects the necessity of creating a uniform, nationwide set of rules by which the independent auditor is to calculate the annual payments." *Connecticut*, 905 A.2d at 50; *see also Indiana*, 879 N.E.2d at 1219-20; *West Virginia*, 681 S.E.2d at 109-12; *Alabama*, 1 So.3d at 13-14.

If decisionmaking regarding payments and allocation under the MSA were balkanized among more than 50 state and territorial courts, the result would be "chaos" resulting from "potentially

conflicting decisions by multiple tribunals," which would "defeat[] the whole purpose" of the Agreement. *North Dakota*, 732 N.W.2d at 730 (internal quotation omitted). Submitting such disputes "to a neutral panel of competent arbitrators, who are guided by one clearly articulated set of rules that apply universally in a process where all parties can fully and effectively participate, obviates this problem and ensures fairness for all parties to the [MSA]." *Id.* (internal quotation omitted); *see also Massachusetts*, 864 N.E.2d at 512-13; *Vermont*, 945 A.2d at 894-95; *New Mexico*, 194 P.3d at 754-55.

The need for uniform nationwide adjudication is particularly compelling with respect to the MSA's "diligent enforcement" provision. Because that provision deals with the allocation of an NPM Adjustment among the States, each State has an obvious incentive to have that issue adjudicated in its own courts. At the same time, however, each State has an interest in the "diligent enforcement" determination with respect to every other State. "Because a diligent-enforcement determination as to one settling state will have an adverse impact on the remaining nonexempt settling states, it is essential that disputes regarding diligent enforcement be resolved in a national arbitration proceeding." *Alabama*, 1 So.3d at 13; *see also id.* ("Individual resolution of diligent-enforcement disputes in 52 separate state courts would involve the application of different standards in determining what activities constitute diligent enforcement and could lead to inconsistent and conflicting determinations on the issue."); *Nevada*, 199 P.3d at 834 ("The MSA's requirement that diligent enforcement disputes be arbitrated makes sense, given the inherently

national character of payment related disputes."); *Maryland*, 944 A.2d at 1180 ("In the case of diligent enforcement, a single decision-maker is vitally important ...."). In sum, "the NPM Adjustment and its inextricably linked defense of diligent enforcement have nationwide repercussions," *Indiana*, 879 N.E.2d at 1220, which is precisely why the MSA unambiguously assigned those issues to a single nationwide decisionmaker in the first place.

At bottom, however, this petition concerns not only the payment and allocation of billions of dollars under a landmark nationwide agreement, but the integrity and supremacy of federal law. Only this Court can correct the decision below, which flouts the FAA and turns the MSA on its head. And only this Court can remind state courts of their solemn obligation to enforce federal arbitration law, whether they like it or not. As this Court recently explained, "[g]iven the substantive supremacy of the FAA, but the Act's nonjurisdictional cast, state courts have a prominent role to play as enforcers of agreements to arbitrate." *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1272 (2009). All of the other state courts understood and respected this obligation; only the Montana Supreme Court—ironically, the *last* of all the state courts to address this issue—did not.

If anything, this case only underscores the Montana Supreme Court's ongoing "war against arbitration." Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139, 178 (2005). Even after this Court reversed the Montana

Supreme Court in *Casarotto*,[2] that court has continued to "express its hostility to arbitration," and has imposed "the regulation if not the prohibition of pre-dispute arbitration clauses in Montana." *Id.* at 178, 200 (citing, *inter alia*, *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1, 14 n.3 (Mont. 2002)); *see also* Bryan

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[2] In the Montana Supreme Court's decision in *Casarotto* itself, a specially concurring opinion declared that "people in the federal judiciary, especially at the appellate level," have "misinterpret[ed] congressional intent when it enacted the Federal Arbitration Act," and exhibited "arrogance" and "an intellectual detachment from reality," as well as "a self-serving disregard for the purposes for which courts exist," by letting "concern for their own crowded docket overcome their concern for the rights they are entrusted with," that federal FAA decisions constitute "insidious erosions of state authority and the judicial process" that "threaten to undermine the rule of law as we know it," that arbitration provisions "subvert our system of justice as we have come to know it," and that "[i]f any foreign government tried to do the same, we would surely consider it a serious act of aggression." *Casarotto v. Lombardi*, 886 P.2d 931, 939-41 (Mont. 1994) (Trieweiler, J., specially concurring), *vacated*, 515 U.S. 1129 (1995), *on remand*, 901 P.2d 596 (Mont. 1995), *rev'd*, 517 U.S. 681 (1996).

Thereafter, on remand from this Court in *Casarotto*, two Justices of the Montana Supreme Court refused to sign the order vacating the court's judgment and allowing arbitration to proceed, in what has been described as "a final act of defiance at the federal authorities." Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139, 177 (2005). According to these Justices: "We cannot in good conscience be an instrument of a policy which is legally unfounded, socially detrimental and philosophically misguided as the United States Supreme Court's decision in this and other cases which interpret and apply the Federal Arbitration Act." Richard C. Reuben, *Western Showdown: Two Montana Judges Buck the U.S. Supreme Court*, ABA J., Oct. 1996, at 16.

L. Quick, *Keystone, Inc. v. Triad Systems Corporation: Is The Montana Supreme Court Undermining The Federal Arbitration Act?*, 63 Mont. L. Rev. 445, 447 (2002) (discussing "how the Montana Supreme Court has contradicted the precedent established by the U.S. Supreme Court on the FAA," "contravene[d] the congressional intent and purpose of the FAA," and engaged in a "refusal to correctly apply the FAA to arbitration agreements"); Carroll E. Neesemann, *Montana Court Continues Its Hostility to Mandatory Arbitration*, 58-APR Disp. Resol. J. 22, 26 (2003) (noting that the Montana Supreme Court's decisions show that "the judicial animosity toward arbitration that prompted the passage of the FAA is still alive").[3]

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[3] At least one commentator has reported that Justice Nelson—the author of the decision below—"has been crisscrossing the state, presenting a Continuing Legal Education program in which he further elaborates on the standards the [Montana Supreme Court] has set" for the enforcement of arbitration clauses, and gives participants guidance regarding what they must do to "void [an] arbitration clause" consistent with that court's decisions. *War Against Arbitration*, 66 Mont. L. Rev. at 199. Based on a review of these materials, this commentator concluded: "The message seems to be: if you are so foolish as to think you can avoid the court system by putting an arbitration clause in your contract, think again." *Id.* at 200; *see also Martz v. Beneficial Mont., Inc.*, 135 P.3d 790, 796 (Mont. 2006) (Nelson, J., specially concurring) ("[T]he United States Supreme Court has, from the beginning, improperly conflated the Federal Arbitration Act (FAA) into something which Congress never intended it to be."); *id.* ("[U]nder the High Court's jurisprudence, the FAA and pre-dispute arbitration clauses in contracts of adhesion have now become little more than instruments of economic Darwinism by which predatory lenders ... and other large corporations victimize main-street

As one commentator recently observed, unless and until this Court intervenes, "arbitration is dead in Montana." *War Against Arbitration*, 66 Mont. L. Rev. at 200. Because the decision below is both clearly erroneous and pernicious, petitioners respectfully suggest that summary reversal is warranted. *See, e.g.*, *Presley v. Georgia*, 130 S. Ct. __, 2010 WL 154813 (U.S. Jan. 19, 2010) (*per curiam*); *Michigan v. Fisher*, 130 S. Ct. 546 (2009) (*per curiam*); *Porter v. McCollum*, 130 S. Ct. 447 (2009) (*per curiam*); *Wong v. Belmontes*, 130 S. Ct. 383 (2009) (*per curiam*); *Bobby v. Van Hook*, 130 S. Ct. 13 (2009) (*per curiam*); *Corcoran v. Levenhagen*, 130 S. Ct. 8 (2009) (*per curiam*). To leave the decision below undisturbed would be to send a decidedly negative signal about the enforcement of federal arbitration rights in state court.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of certiorari, and either summarily reverse the decision below or set the case for plenary consideration.

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businesses, the unsophisticated, the elderly, the poor, and what is left of the middle class."); *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1, 14 n.3 (Mont. 2002) (Nelson, J., specially concurring for a majority of the Court) (urging that this Court's precedents holding that the FAA applies in state courts "should be overruled").

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January 29, 2010

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DA 07-0299

IN THE SUPREME COURT OF
THE STATE OF MONTANA

2009 MT 261

STATE OF MONTANA, ex rel. STEVE BULLOCK,

Plaintiff and Appellant,

v.

PHILIP MORRIS, INC., et al.,

Defendants and Appellees.

FILED
August 5 2009
Ed Smith
CLERK OF THE SUPREME
COURT
STATE OF MONTANA

APPEAL FROM: District Court of the First Judicial District, In and For the County of Lewis and Clark, Cause No. CDV 1997-306 Honorable Thomas C. Honzel, Presiding Judge

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Submitted on Briefs Dec. 19, 2007.
Decided Aug. 5, 2009.

Justice James C. Nelson delivered the Opinion of the Court.

¶1 The State of Montana appeals from an order entered by the First Judicial District Court, Lewis and Clark County, granting the motion of Philip Morris USA Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company to compel arbitration. We reverse and remand for further proceedings.

BACKGROUND

¶2 This appeal arises out of litigation that began in 1997, when the State sued the nation's largest tobacco manufacturers for the public health costs caused by the industry's alleged ongoing misrepresentations to consumers about the risks of smoking. Other states and territories filed similar litigation. In 1998, four of the tobacco manufacturers (Philip Morris, R.J. Reynolds, Lorillard, and Brown & Williamson Tobacco Corp.[1]) entered into a Master Settlement Agreement (MSA)

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[1] Brown & Williamson merged with R.J. Reynolds in 2004.

with 46 states (including Montana[2]), the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa, and the Northern Mariana Islands. These four defendants are referred to in the MSA as "original participating manufacturers" (OPMs), and the states, territories, and District of Columbia are referred to as the "Settling States." The MSA permits other tobacco companies to join the settlement in order to avoid future litigation, and the companies which have done so are designated "subsequent participating manufacturers" (SPMs). A number of SPMs have intervened in the present suit. Finally, the original participating manufacturers and the subsequent participating manufacturers are known collectively as "participating manufacturers" (PMs), while the tobacco companies that are not signatories to the MSA are known as "non-participating manufacturers" (NPMs).

¶3 In exchange for the Settling States' release of all claims, the PMs agreed to certain marketing restrictions and to make annual payments to the Settling States "for the advancement of public health" and "the implementation of important tobacco-related public health measures." The PMs do not make payments directly to individual Settling States; rather, each PM is required to make a single, nationwide payment into an escrow account, and the amounts are then allocated among the Settling

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[2] The tobacco companies and four states (Florida, Minnesota, Mississippi, and Texas) entered into individual settlement agreements.

States. Each PM's individual contribution to the account is based on its market share. Likewise, each Settling State receives an "allocable share" of the sum of all payments made by the PMs in the year in question. Montana's allocable share is 0.4247591%. The State received $24.8 million in MSA funds in 2006; $25.8 million in 2007; and $34.6 million in 2008.

¶4 The MSA assigns several responsibilities to an "Independent Auditor," which is defined as "a major, nationally recognized, certified public accounting firm."[3] Specifically, the Independent Auditor

> shall calculate and determine the amount of all payments owed pursuant to [the MSA], the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States, and shall perform all other calculations in connection with the foregoing....

In calculating the PMs' annual payments, the Independent Auditor takes the base amount owed by the PMs for the calendar year and then applies a series of adjustments, reductions, and offsets. Of relevance to this case is the Non-Participating

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[3] The parties selected Pricewaterhouse-Coopers as the Independent Auditor.

Manufacturer Adjustment (NPM Adjustment). The parties to the MSA recognized that the marketing restrictions and payment obligations imposed on PMs could give NPMs a competitive advantage and cause the PMs to lose market share to the NPMs. Moreover, they recognized that a transfer of market share to the NPMs would undermine the purposes of the MSA. Thus, the NPM Adjustment serves to level the playing field by reducing the PMs' annual payment obligations if it is determined that (1) the PMs collectively lost more than two percent of their pre-MSA (i.e., 1997) aggregate market share to NPMs during the year in question and (2) "the disadvantages experienced as a result of the provisions of [the MSA] were a significant factor contributing to" this loss.

¶5 The NPM Adjustment typically applies to the allocated payment for each Settling State; however, a Settling State can avoid the NPM Adjustment if it "continuously had a Qualifying Statute ... in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year." A "Qualifying Statute" is a statute, regulation, law, or rule that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of [the MSA]." If a Settling State meets these requirements, then the NPM Adjustment is inapplicable to that Settling State and is reallocated among the other Settling States on a pro rata basis.

¶6 The present litigation concerns the PMs' annual payments for 2006. The PMs had lost the requisite percentage of market share in 2003, and an economic consulting firm had determined that the disadvantages imposed by the MSA were a "significant factor" contributing to that loss. Thus, the PMs asked the Independent Auditor to offset their 2006 payments by the amount of the 2003 NPM Adjustment. In response, the Settling States contended that they each had enacted Qualifying Statutes which were in full force and effect in 2003 and that the Independent Auditor should presume, in the absence of substantial evidence to the contrary, that state officials had "diligently enforced" those statutes. The PMs, however, argued that the Independent Auditor must "presume just the opposite," i.e., that the statutes had *not* been diligently enforced.

¶7 The Independent Auditor declined to apply the NPM Adjustment to the PMs' 2006 payments. Noting the parties' dispute over whether the Settling States continuously had Qualifying Statutes "in full force and effect" and whether they "diligently enforced" the provisions of such statutes, the Independent Auditor explained that it was "not charged with the responsibility under the MSA of making a determination regarding this issue." Moreover, the Independent Auditor stated that it was "not qualified to make the legal determination as to whether any particular Settling State has 'diligently enforced' its Qualifying Statute." Thus, the Independent Auditor concluded that "[u]ntil such time as the parties resolve this issue or the issue is resolved by a trier of fact, the Independent Auditor will not modify its current approach to the

application of the NPM Settlement Adjustment." In effect, the Independent Auditor presumed that the Settling States had diligently enforced their Qualifying Statutes.

¶8 On April 10, 2006, the OPMs served notice that they disputed the Independent Auditor's final calculations. Nevertheless, the OPMs paid the full amounts calculated by the Independent Auditor, though R.J. Reynolds and Lorillard paid the sums attributable to the disputed amount into the Disputed Payments Account provided for in the MSA.

¶9 The State then commenced the instant action on May 8, 2006, by filing a motion for declaratory order. The State alleged that Montana had enacted a Qualifying Statute (§§ 16-11-401 to -404, MCA) in 1999 when the Legislature adopted the Model Statute set forth in Exhibit T of the MSA. The State further alleged that the provisions of §§ 16-11-401 to -404, MCA, were continuously in full force and effect during 2003 and that the State had diligently enforced these provisions during that year. The State relied on the presumption contained in § 26-1-602(15), MCA ("[o]fficial duty has been regularly performed") and also listed certain actions it had taken to enforce §§ 16-11-401 to -404, MCA. The State asked the District Court to enter an order declaring that Montana diligently enforced the provisions of §§ 16-11-401 to -404, MCA, during 2003. In the alternative, the State asked the District Court to determine that the PMs "have released, waived, or are estopped to assert any claim that Montana did not diligently enforce the Model Statute with regard to the 2003 escrow payment."

The State alleged that the court had jurisdiction under § VII(a)(2) of the MSA, which provides that each individual state court retains exclusive jurisdiction for the purposes of "implementing and enforcing" the MSA and the Consent Decree as to such Settling State.

¶10 The OPMs responded with a motion to compel arbitration (which the intervening SPMs joined). They relied on § XI(c) of the MSA, which states:

> **Resolution of Disputes.** Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independ nt Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge ....

The OPMs argued that the parties' dispute was one "arising out of or relating to calculations performed by, or ... determinations made by, the Independent Auditor." The OPMs also asserted that the parties' dispute concerned the "application" of an adjustment "described in subsection IX(j)" (namely, the NPM Adjustment). The OPMs next argued that allowing Settling States to challenge the Independent Auditor's determinations in their

respective state courts would "wreak havoc" on the MSA's payment system. Lastly, the OPMs contended that the law favors arbitration when a contract contains an arbitration clause.

¶11 In response, the State emphasized that it sought a ruling only with respect to its own diligent enforcement efforts and that it was not asking the District Court to calculate any payments or adjustments. The State also pointed out that the arbitration provision applies only to "calculations performed by" and "determinations made by" the Independent Auditor, and the State argued that the Independent Auditor is, by definition, an accounting firm which is not vested by the MSA with responsibility for evaluating the exercise of prosecutorial discretion by the various state attorneys general to determine whether their respective Qualifying Statutes have been diligently enforced.

¶12 The District Court agreed with the State that the MSA does not define "diligent enforcement," does not outline the standard by which a Settling State meets this requirement, and does not expressly charge the Independent Auditor with the duty of determining whether a Settling State has "diligently enforced" its Qualifying Statute. Nevertheless, the court concluded that the parties' dispute "concerning the Auditor's determination not to apply the 2003 NPM Adjustment" was a matter for arbitration. The court first observed that the issue of whether "diligent enforcement" has occurred is "necessarily linked" to whether the NPM Adjustment applies. The court then reasoned that although the Independent Auditor did not explicitly determine

that the Settling States were diligently enforcing their Qualifying Statutes, the Independent Auditor "presumed" that they were. In the District Court's view, this "presumption of 'diligent enforcement' is essentially a determination and, under Section IX(c), MSA, this determination is a matter for arbitration." The State now appeals.

ISSUE

¶13 The sole issue on appeal is whether the District Court erred in granting the PMs' motion to compel arbitration.

STANDARD OF REVIEW

¶14 This Court reviews a district court's order granting a motion to compel arbitration de novo. *Martz v. Beneficial Montana*, 2006 MT 94, ¶ 10, 332 Mont. 93, 135 P.3d 790.

DISCUSSION

¶15 Arbitration is a matter of contract, and a party cannot be required to submit to arbitration a dispute which it has not agreed so to submit. *AT&T Technologies v. Communications Workers of America*, 475 U.S. 643, 648, 106 S. Ct. 1415, 1418, 89 L.Ed.2d 648 (1986); accord *Willems v. U.S. Bancorp Piper Jaffray*, 2005 MT 37, ¶ 13, 326 Mont. 103, 107 P.3d 465. Moreover, unless the parties "clearly and unmistakably" provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator. *AT&T Technologies*, 475 U.S. at 649, 106 S. Ct. at 1418; *cf. Kingston v. Ameritrade*, 2000 MT 269, ¶ 13, 302 Mont. 90, 12 P.3d 929 ("[A] district court 'may not order arbitration if there is a substantial and bona fide dispute over whether there exists an agreement

to arbitrate." (citing § 27-5-115, MCA)). Thus, the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate *that dispute*. *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614, 626, 105 S. Ct. 3346, 3353, 87 L. Ed.2d 444 (1985); *cf. Willems*, ¶ 13 ("When a district court is asked to compel arbitration of a dispute, the threshold inquiry is whether the parties agreed to arbitrate."). When deciding whether the parties agreed to arbitrate a certain matter, courts generally should apply ordinary state-law principles that govern the formation of contracts. *See First Options of Chicago v. Kaplan*, 514 U.S. 938, 944, 115 S.Ct. 1920, 1924, 131 L.Ed.2d 985 (1995); *Willems*, ¶ 13 ("Because arbitration is a matter of contract, the rules of contract apply."); § 28-3-102, MCA ("A contract is to be interpreted according to the law and usage of the place where it is to be performed ...."). Indeed, the MSA itself states that "[t]his Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State."

¶16 Under Montana law, the construction and interpretation of a contract is a question of law for the court to decide. *Ophus v. Fritz*, 2000 MT 251, ¶ 19, 301 Mont. 447, 11 P.3d 1192. "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." Section 28-3-301, MCA. "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone if possible ...." Section 28-3-303, MCA. "The whole of a contract is to be taken together so as to give effect to

every part if reasonably practicable, each clause helping to interpret the other." Section 28-3-202, MCA. "The language of a contract is to govern its interpretation if the language is clear and explicit and does not involve an absurdity." Section 28-3-401, MCA. "A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect if it can be done without violating the intention of the parties." Section 28-3-201, MCA. Laws existing at the time a contract is formed become part of the contract. *Earls v. Chase Bank of Texas*, N.A., 2002 MT 249, ¶ 12, 312 Mont. 147, 59 P.3d 364. If the language of a contract is unambiguous—i.e., reasonably susceptible to only one construction—the court must apply the language as written. *Mary J. Baker Revoc. Trust v. Cenex Harvest States*, 2007 MT 159, ¶ 19, 338 Mont. 41, 164 P.3d 851.

¶17 Again, the MSA's arbitration provision (§ XI(c)) provides, in relevant part, that

> [a]ny dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration.

¶18 In applying this provision, we must first identify the parties' "dispute, controversy or claim."

The PMs frame the dispute in rather broad and imprecise terms. Specifically, they assert that the parties' dispute is over "the Auditor's determination not to apply the 2003 NPM Adjustment." As noted, the PMs lost the requisite percentage of market share in 2003, and an economic consulting firm determined that the disadvantages imposed by the MSA were a "significant factor" contributing to that loss. These facts triggered an NPM adjustment; however, the MSA states that a Settling State's allocated payment "shall not" be subject to an NPM Adjustment if the Settling State continuously had a Qualifying Statute in full force and effect and diligently enforced the provisions of such statute. Yet, while the MSA provides comprehensive formulas for determining whether an NPM Adjustment is triggered, the MSA does not provide such formulas for evaluating "diligent enforcement" of a Qualifying Statute. Nor does it state what entity is responsible for conducting that evaluation. The Independent Auditor concluded that it was neither responsible nor qualified to determine diligent enforcement; and, for that matter, the parties did not suggest that the Independent Auditor should make this determination. Rather, the PMs argued that the Independent Auditor should presume that the Settling States had not diligently enforced Qualifying Statutes, while the Settling States argued in favor of the opposite presumption. The Independent Auditor ultimately adopted the Settling States' approach and presumed diligent enforcement, and *that* is what the PMs dispute-i.e., the Independent Auditor's decision to presume diligent enforcement rather than presume no diligent enforcement.

¶19 But that is not the dispute here. The State filed the instant action not to challenge any calculation, determination, or course of action actually performed, made, or chosen by the Independent Auditor. Rather, the State sought a declaration that Montana had, in fact, diligently enforced the provisions of §§ 16-11-401 to -404, MCA, during 2003. Notably, the PMs have not alleged that Montana did *not* diligently enforce these statutes. In any event, the dispute in the present case, as framed in the State's motion, is whether Montana diligently enforced a Qualifying Statute. We reject the PMs' attempts to repackage the dispute in this case as something it clearly is not.

¶20 The second question is whether this dispute is one "arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor." We agree with the State that it is not. The Independent Auditor neither "calculated" nor "determined" whether Montana diligently enforced a Qualifying Statute. Rather, the Independent Auditor simply presumed that Montana did so, and we cannot agree that this constitutes a "determination" as contemplated by the MSA. To "presume" is "to suppose to be true without proof." *Merriam-Webster's Collegiate Dictionary* 923 (10th ed., Merriam-Webster 1997). To "determine," by contrast, involves something more affirmative, such as "to find out or come to a decision about by investigation, reasoning, or calculation." *Merriam-Webster's Collegiate Dictionary* 315. Here, the Independent Auditor refused to conduct any "investigation, reasoning, or calculation" regarding whether the Settling States had diligently enforced their Qualifying Statutes. In this connection, it is

important to bear in mind that the Independent Auditor is defined in the MSA as "a major, nationally recognized, certified public accounting firm," whose duties are to calculate and determine the amounts of payments, to collect all information necessary to make such calculations and determinations, and to allocate such payments. The PMs point to nothing in the MSA supporting their contention that the parties intended for the Independent Auditor to interpret statutes and evaluate whether the prosecutorial activities of the state attorneys general amount to "diligent enforcement" of those statutes. As the Independent Auditor itself stated, it is "not qualified" to make this determination.

¶21 We also agree with the State that the question of whether Montana diligently enforced a Qualifying Statute in 2003 does not "arise out of or relate to" any calculations or determinations that the Independent Auditor actually "performed" or "made." To be sure, the State's motion for declaratory order followed from the Independent Auditor's finding that the PMs lost the requisite percentage of market share in 2003 and from the economists' subsequent determination that the disadvantages imposed by the MSA were a significant factor contributing to that loss. But the State's motion in no way "arises out of or relates to" the Independent Auditor's market-share analysis. Indeed, that analysis has not been challenged. Rather, the State's motion relates to an issue (diligent enforcement) that the Independent Auditor explicitly refused to determine, and it is clear from the language of the arbitration provision that the parties intended to arbitrate only those disputes which arise out of or relate to

calculations or determinations that the Independent Auditor actually "performed" or "made."

¶22 The PMs point to the parenthetical in the arbitration provision, emphasized here:

> Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor *(including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i))* shall be submitted to binding arbitration.

The PMs contend that subsection IX(j) describes the NPM Adjustment and that the language of the parenthetical, therefore, mandates that all disputes "concerning" the "application" of an NPM Adjustment must be arbitrated.

¶23 Again, we disagree. As noted, "[t]he whole of a contract is to be taken together so as to give effect to every part if reasonably practicable, each clause helping to interpret the other." Section 28-3-202, MCA. Moreover, "[w]here there are several provisions or particulars, such a construction is, if possible, to be adopted as will give effect to all." Section 1-4-101, MCA. Reading the parenthetical as the PMs urge, such that any dispute concerning the application of an NPM Adjustment must be arbitrated, would effectively nullify the limiting words "calculations performed by, or any determinations made by" the Independent Auditor. When the arbitration provision is read as a whole, it

is clear that the parties intended to arbitrate only those disputes which involve calculations performed or determinations made by the Independent Auditor. The situations identified in the parenthetical are not "in addition to" those which come before the parenthetical. Rather, the parenthetical, which begins with the word "including," simply lists examples and affirms that any calculations or determinations actually performed or made by the Independent Auditor regarding "any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j)" are to be submitted to arbitration. In this regard, it is important to note that while subsection IX(j) does mention the NPM Adjustment, it makes no mention of "diligent enforcement" or the Settling States' exemption from the NPM Adjustment.

¶24 The PMs also contend that arbitration is compelled by the MSA's "single, unitary payment structure." The PMs opine that if "payment-related disputes" are not resolved through "a single, nationwide arbitration" guided by "one clearly articulated set of rules," the result will be "chaos." Moreover, the PMs argue that because granting one Settling State an exception to the NPM Adjustment effectively reduces the payments to any Settling States which do not qualify for this exception (pursuant to the reallocation provision, *see* ¶ 5, *supra*), nationwide arbitration of the "diligent enforcement" issue for all Settling States is necessary so that each state can participate.

¶25 We are not persuaded. For one thing, our decision must be based on Montana law and the plain language of the arbitration provision, not on

the PMs' policy arguments. If the PMs intended for the "diligent enforcement" question to be arbitrated pursuant to "one clearly articulated set of rules" and with all Settling States present in one nationwide forum, the PMs certainly were capable of negotiating for this requirement in the MSA. As it is, no such language and no such rules appear in the MSA. Moreover, notwithstanding the PMs' apparent concern that some Settling States might suffer reductions to their allocated payments, the fact remains that the question of whether Montana diligently enforced *its* Qualifying Statute does not depend, in any way, on what the other Settling States have or have not done. If Montana diligently enforced a Qualifying Statute, the NPM Adjustment does not apply to it; whether the other Settling States did the same is immaterial.

¶26 As for the PMs' desire for "one clearly articulated set of rules," the PMs' argument in this regard is undercut by the MSA's Governing Law provision, which states that "[t]his Agreement ... shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State." In executing the MSA, the PMs clearly agreed to the application of various state laws, with the possibility of differing outcomes on a single issue. In this connection, § VII(f) of the MSA states:

> **Coordination of Enforcement.** The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling

> States shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

Given this provision, the PMs' concerns about "chaos" and no uniformity of decisions are somewhat overstated. Indeed, even if, as the PMs argue, "one clearly articulated set of rules" is preferable for deciding the "diligent enforcement" issue, this fact does not lead inevitably to the conclusion that nationwide arbitration is "compelled." Certainly the individual state courts are capable of applying uniform rules (should they be promulgated) in a consistent and evenhanded fashion to their respective Settling States.

¶27 Lastly, the PMs cite (in their briefs and in post-briefing notices of supplemental authority) a number of cases from other state courts, each of which concluded that the particular Settling State had agreed to arbitrate the issue of "diligent enforcement." Of course, those decisions are not binding on this Court. Moreover, they are of limited persuasive value given that we are applying Montana law to the particular claims raised by the State in its motion for declaratory order. And, while many of the decisions cited by the PMs appear simply to be following suit with the earlier decisions of other state courts, our independent review of the relevant provisions of the MSA and our application of Montana's well-settled principles of contract interpretation require us to conclude that the State

of Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute.

CONCLUSION

¶28 The District Court erred in granting the PMs' motion to compel arbitration. We accordingly reverse the District Court's order and remand this case for further proceedings consistent with this Opinion.

¶29 Reversed and remanded.

JAMES C. NELSON

We Concur: PATRICIA O. COTTER, W. WILLIAM LEAPHART and BRIAN MORRIS.

Justice Jim Rice, dissenting.

¶30 Courts in 48 states, including the First Judicial District Court for the State of Montana, have reviewed the issue in this case under their own state law, and have unanimously concluded that the Master Settlement Agreement (MSA) requires the issue to be submitted to arbitration. I do not agree with the Court that the uniqueness of Montana law requires a different conclusion. In my view, the Court has made analytical errors in both the application of the law and in the interpretation of the provisions of the MSA which has led to an erroneous decision.

¶31 **I. Policies Favoring Arbitration.**

¶32 The decision in this case should not be made without consideration of the federal and state policies favoring arbitration. Although the Court acknowledges in passing that the manufacturers (OPMs) contend "that the law favors arbitration," the Court fails to consider the effect of this argument or the substantial body of law supporting it. The Court cites U.S. Supreme Court cases for the standards and law relevant to deciding arbitration questions, but it ignores the parts of those same cases which concretely establish an approach strongly favoring arbitration. In *Mitsubishi Motors*, the U.S. Supreme Court stated that "any doubts concerning the *scope* of arbitrable issues should be resolved in favor of arbitration ...." 473 U.S. at 626, 105 S.Ct. at 3353-54 (quotation omitted; emphasis added). In *AT&T Technologies*, the U.S. Supreme Court instructed that arbitration "should not be denied unless it may be said with *positive assurance* that the arbitration clause is *not* susceptible of an

interpretation that covers the asserted dispute." *AT & T Technologies*, 475 U.S. at 650, 106 S.Ct. at 1419 (quotation omitted; emphasis added). The fact that 48 jurisdictions, including 20 appellate courts, have determined that the arbitration clause here *is* "susceptible of an interpretation that covers the dispute" should give us pause.

¶33 Our Court has likewise recognized this policy in favor of arbitration. *See Vukasin v. D.A. Davidson & Co.*, 241 Mont. 126, 785 P.2d 713 (1990); *Topolski v. Helena Assn. of Realtors, Inc.*, 2000 MT 343, ¶ 9, 303 Mont. 224, 15 P.3d 414. Although the Court cites *Kingston*, ¶ 13, for the proposition that arbitration may not be ordered "if there is a substantial and bona fide dispute over whether there exists an agreement to arbitrate," that statement should be taken in its context—we held there that the district court erred in "not fully addressing whether a valid arbitration agreement exists" before looking to the policy favoring arbitration, which we nonetheless recognized. *Kingston*, ¶¶ 16, 20. Here, a valid arbitration agreement indisputably exists, and thus the policy favoring submission of this particular dispute to that arbitration agreement should be applied, and should form the backdrop of the interpretational issues raised herein.

¶34 II. Interpreting and Applying the Contract Language.

¶35 The parties dispute the Independent Auditor's decision to presume "diligent enforcement" by the State of Montana in determining the amount of the NPM Adjustment and, consequently, the final payment amount. Section XI(c) of the MSA states, in pertinent part, as follows:

> Resolution of Disputes. Any dispute, controversy, or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge.

¶36 I would first dispute the Court's conclusion about what is incorporated within this provision. In rejecting the OPMs' interpretation, the Court states that "it is important to note that while subsection IX(j) does mention the NPM Adjustment, it makes no mention of 'diligent enforcement' or the Settling States' exemption from the NPM Adjustment." Opinion, ¶ 23. This is incorrect. Subsection IX(j) provides that "the NPM Adjustment shall be applied ... pursuant to subsections IX(d)(1) and (d)(2)," and, in turn, subsection IX(d)(2) is the provision which establishes "diligent enforcement" and the Settling States' exemption. Contrary to the Court's view, the arbitration provision incorporates by reference the very provisions out of which the dispute in this case arises. Thus, the parenthetical phrase in the arbitration provision, which provides examples "without limitation" of disputes that should be arbitrated, specifically incorporates the "diligent enforcement" exception to the NPM Adjustment and

the Settling States' exemption from the NPM Adjustment, and clearly demonstrates that these are areas in which the arbitration provision was intended to operate.

¶37 The Court further unduly narrows the scope of the parenthetical phrase. It states that the phrase "simply lists examples and affirms that any calculations or determinations actually performed or made" are to be submitted to arbitration. Opinion, ¶ 23. However, the parenthetical provides examples, not merely of *determinations*, but of *disputes concerning* such determinations ("including, without limitation, any dispute concerning ... any of the adjustments"). The Court likewise fails to apply the "arising out of or relating to" language to this listing of disputes, to which I now turn.

¶38 A critical phrase within the arbitration clause is "arising out of or relating to." Within the context of arbitration, this phrase is interpreted nationally as playing the important role of signifying the intent to broadly require arbitration concerning the subject matter specified. In *Fleet Tire Serv. of N. Little Rock v. Oliver Rubber Co.*, 118 F.3d 619, 621 (8th Cir. 1997), the court held that the term "relating to" in an agreement "constitutes the broadest language the parties could reasonably use to subject their disputes to that form of settlement, including collateral disputes." *See also Collins & Aikman Prods. Co. v. Building Sys., Inc.*, 58 F.3d 16, 20 (2d Cir. 1995) (an agreement requiring arbitration for " 'any claim or controversy arising out of or relating to the agreement,' is the paradigm of a broad clause"); *Mitsubishi Motors*, 473 U.S. at 625, 105 S. Ct. at 3353, n. 13 ("[T]he exclusion of some areas of

possible dispute from the scope of an arbitration clause does not serve to restrict the reach of an otherwise broad clause in the areas in which it was intended to operate."). Thus, when interpreting the arbitration provision, the broad application which the law has given to "arising out of or relating to" should properly be considered.

¶39 Therefore, based upon a reading of the MSA as a whole, arbitration is required for (1) any dispute, controversy or claim, (2) arising out of or relating to (3) calculations performed by, or any determinations made by, the Independent Auditor (4) including, without limitation, disputes concerning the operation or application of any of the adjustments, including the NPM Adjustment, diligent enforcement, or the Settling States' exemption from the NPM Adjustment. Here, the Independent Auditor decided to presume "diligent enforcement" by the Settling States in determining the NPM Adjustment and the final payment. This decision resulted in a financial calculation which is more than one billion dollars different than had the Auditor decided to apply the NPM Adjustment without presuming "diligent enforcement." Given the law's policy favoring arbitration, and given the MSA's broad directive to arbitrate matters "relating to" calculations made by and "any determinations made by" the Auditor, including those "concerning" the operation or application of adjustments, specifically, the NPM Adjustment, I would conclude that whether Montana diligently enforced its statute, which impacts the amount of the NPM Adjustment, is a dispute which must be arbitrated under the MSA.

¶40 I believe the Court has made interpretational errors in reaching the opposite conclusion, in addition to those discussed above. The Court's decision hangs on two propositions which are, in my view, extremely narrow and contrived interpretations of the MSA. First, the Court concludes that the Auditor did not actually make a "determination" regarding the NPM Adjustment, but, rather, merely made a "presumption" about the Adjustment. Distinguishing between dictionary definitions of "determine" and "presume," the Court concludes that the Auditor's action (which resulted in a billion dollar difference in the final payment calculation) was merely a presumption which fell outside of the arbitration provision. However, given that all controversies "related to" the Auditor's "calculations" or "determinations" are to be arbitrated, and are to be broadly interpreted, I must disagree with this narrow approach.

¶41 Secondly, the Court reasons that the Auditor, instead of making a calculation, actually "refused to conduct" any calculation or investigation here, and therefore, this dispute is not subject to arbitration because the MSA requires arbitration of only those calculations "that the Independent Auditor actually performed or made." Opinion, ¶¶ 20, 21. However, the Auditor had the responsibility of applying the NPM Adjustment and to do so, was forced to make a decision on diligent enforcement. It is undisputed that the Auditor did not fail to act-it acted by making the decision to presume diligent enforcement. Again, under the policies favoring arbitration, I view the Court's approach to be a hyper-technical reading of the MSA.

¶42 The Court's approach does not truly ask whether the dispute *arises out of or relates to* an Auditor's determination, but, rather, narrowly asks whether a dispute *consists* of an Auditor's determination. The Court offers that the Auditor's market-share analysis "has not been challenged." Opinion, ¶ 21. Here, the Court has made an assumption that the Auditor is merely a glorified calculator, and that the MSA requires arbitration only of the Auditor's numerical calculations. I believe this is a significant narrowing of the plain language of the arbitration provision. Had the parties intended arbitration to be limited to the Auditor's calculations, I suspect the arbitration panel would have consisted of accountants instead of federal judges. In reality, the Auditor could not have "calculated" the final payment without making determinations concerning the NPM Adjustment and diligent enforcement.

¶43 I believe the Court has applied an overly narrow interpretation of the terms of the MSA and has failed to consider the policies favoring arbitration. I dissent and would affirm the District Court.

JIM RICE

DA 07-0299

IN THE SUPREME COURT OF
THE STATE OF MONTANA

2009 MT 261

STATE OF MONTANA, ex rel. STEVE BULLOCK,

Plaintiff and Appellant,

v.

PHILIP MORRIS, INC., et al.,

Defendants and Appellees.

FILED
September 10, 2009
Ed Smith
Clerk of the Supreme Court
State of Montana

ORDER

We rendered our Opinion in the above-entitled action on August 5, 2009. *State ex rel. Bullock v. Philip Morris, Inc.*, 2009 MT 261. The PMs have filed a petition for rehearing, and the State as [sic] filed its response to the petition. This Court will consider a petition for rehearing presented only upon the following grounds:

> i. That it overlooked some fact material to the decision;
> ii. That it overlooked some question presented by counsel that would have proven decisive to the case; or
> iii. That its decision conflicts with a statute or controlling decision not addressed by the supreme court.

M.R. App. P. 20(1)a. The PMs have failed to demonstrate any of these grounds for rehearing.

First, many of the PMs' arguments in their petition are devoted to challenging the State's interpretation of the MSA. For instance, the PMs

contend that "[t]he State's interpretation overlooks critical language," that "[t]he State's interpretation would render the 'arising out of or relating to' language meaningless," that "[t]he State's interpretation also violates basic rules of grammar," and that "[t]he entire premise for the State's argument ... is refuted by the record." However, the State presented its interpretations and arguments regarding the MSA in its opening brief on appeal, and the PMs then had the opportunity to respond—and did respond—to the State in their response brief. This Court, in turn, considered the parties' respective interpretations of the MSA when rendering its decision, and the PMs have not shown that we overlooked some decisive question raised by counsel. A petition for rehearing is not a forum in which to rehash arguments made in the briefs and considered by the Court. M.R. App. P. 20(1)a.

Second, the PMs assert that this Court was the last to decide the issue of whether a Settling State's diligent enforcement efforts must be arbitrated, but that the parties' briefing on which we relied was outdated and "did not reflect the analysis and holdings" of subsequent decisions of other state courts. As the PMs acknowledge, however, they provided us with the subsequent state-court decisions through nine separate notices of supplemental authority. We considered the reasoning of those decisions but were not persuaded by it. Moreover, as noted in ¶¶ 15 and 27 of the Opinion, we are applying *Montana's* contract law to determine whether the parties agreed to arbitrate the present dispute. The PMs have not shown that we overlooked any controlling factual or legal matter contained in the post-briefing state-court decisions.

Lastly, the PMs urge that as a factual matter, we have misunderstood the "dispute" in this case. The PMs assert that the dispute is not simply whether Montana diligently enforced the provisions of §§ 16-11-401 to -404, MCA; rather, the PMs claim that "it includes numerous issues arising out of and relating to the Auditor's determination not to apply the NPM Adjustment, including whether the Auditor properly denied the PMs' request to apply the adjustment." The PMs contend that our decision "simply ignores these and other issues relating to the 2003 NPM Adjustment dispute." It appears, however, that the PMs are again attempting to confuse the narrow dispute raised by the State in the present litigation. The State has sought a declaration that Montana diligently enforced the provisions of §§ 16-11-401 to -404, MCA, during 2003—nothing more. As noted in ¶ 21 of the Opinion, the State filed its motion for declaratory order after the Independent Auditor determined that the PMs had lost the requisite percentage of market share in 2003 and after the economists determined that the disadvantages imposed by the MSA were a significant factor contributing to that loss. However, the State might just as well have filed its motion on January 2, 2004, long before those determinations were made. Any dispute over whether the State of Montana, as a factual and legal matter, actually met the standards for "diligent enforcement" of a Qualifying Statute in 2003 does not arise out of or relate to the Independent Auditor's market-share analysis, to the Independent Auditor's decision to apply an interim presumption of diligent enforcement, or to the enforcement efforts of the other Settling States. In short, the State's request for a declaration of diligent

enforcement simply does not "aris[e] out of or relat[e] to calculations performed by, or any determinations made by, the Independent Auditor"—the PMs' continuing protests notwithstanding.

The PMs have not shown that this Court overlooked some fact material to its decision or some question presented by counsel that would have proven decisive to the case, or that our decision conflicts with a statute or controlling decision not addressed by the Court. Accordingly,

IT IS HEREBY ORDERED that the Participating Manufacturers' Petition for Rehearing is DENIED.

IT IS FURTHER ORDERED that the Clerk of this Court give notice of this Order by mail to the Attorney General and to the Participating Manufactures at their last known addresses.

DATED this 9th day of September, 2009.

JAMES C. NELSON, PATRICIA O. COTTER, W. WILLIAM LEAPHART, and BRIAN MORRIS.

Justice Jim Rice would grant the Petition for Rehearing.

MONTANA FIRST JUDICIAL DISTRICT COURT
LEWIS AND CLARK COUNTY

STATE OF MONTANA, ex rel, MIKE MCGRATH

Plaintiff,

v.

PHILIP MORRIS, INCORPORATED; R.J. REYNOLDS TOBACCO CO.; AMERICAN TOBACCO CORP.; BROWN & WILLIAMSON TOBACCO CORP.; LIGGETT & MEYERS, INC.; LORILLARD TOBACCO COMPANY; UNITED STATES TOBACCO COMPANY; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; RJR NABISCO HOLDINGS CORP.; RJR NABISCO, INC.; HILL & KNOWLTON, INC.; THE COUNCIL FOR TO[B]ACCO RESEARCH - U.S.A., INC.; and TOBACCO INSTITUTE, INC.,

Defendants.

Case No.: CDV-1997-306

MEMORANDUM AND ORDER ON DEFENDANTS' MOTION TO COMPEL ARBITRATION

Before the Court is Defendant R.J. Reynolds Tobacco Company, Philip Morris, Inc., and Lorillard Tobacco Company's motion to compel arbitration under the Master Settlement Agreement. The motion was heard September 27, 2006. The Court concludes that the motion should be granted.

BACKGROUND

This matter arises out of the Master Settlement Agreement (MSA) entered into between 46 states, (including Montana), the District of Columbia, Puerto Rico and 4 U.S. territories (collectively the Settling States), and the United States' 4 largest tobacco companies, R.J. Reynolds Tobacco Company, Inc., Lorillard Tobacco Company, Philip Morris, Inc.,

and Brown & Williamson Tobacco Company (collectively the Original Participating Manufacturers (OPMs). The MSA was entered into after the Settling States sued the OPMs over the increase in state payments for health care costs associated with tobacco-related illnesses. Several smaller tobacco companies have also signed the MSA and are known as Subsequent Participating Manufacturers (SPMs). Collectively, the OPMs and SPMs are known as Participating Manufacturers (PMs) and those companies that have not signed the MSA are known as Non-Participating Manufacturers (NPMs).

By entering into the MSA, the Settling States released the PMs from all past and future claims. In exchange for the releases, the PMs agreed, among other things, to specific marketing restrictions and to make annual payments to the Settling States to help cover tobacco-related illness. Under the MSA, the Independent Auditor (Auditor), designated in the MSA as PricewaterhouseCoopers, calculates and determines the single annual payment that each PM must make each calendar year. Once the PMs make their payments, the Auditor distributes that money to each Settling State according to its predetermined allocable share.

The aggregate annual payment, however, is subject to various adjustments, one of which is the NPM Adjustment. (Section IX(d)(1), MSA.) The theory behind the NPM Adjustment is that the payment obligation and marketing restrictions could disadvantage the PMs competitiveness and cause them to lose market share to those manufacturers who did not join the MSA. Thus, the NPM

Adjustment effectively reduces the annual payment of PMs if the two following criteria are met: (a) the PMs suffer a "Market Share Loss," and (b) an independent firm of economic consultants finds that the MSA was a "significant factor" contributing to the Market Share Loss. (Section IX(d)(1), MSA.)

However, under the MSA, a Settling State can avoid the NPM Adjustment if it: (a) enacts a "Qualifying Statute" that imposes restrictions and obligations on NPMs similar to those placed on PMs, and (b) the state "diligently enforces" the statutes. (Section IX(d)(2)(B), MSA.) Montana, like every other Settling State, has adopted Qualifying Statutes. *See* Sections 16-11-401 to 404, MCA.

In 2004, the Auditor found that PMs suffered a "Market Share Loss" for 2003. Subsequently, in March 2006, an economic consulting firm also determined that the MSA was likely the cause of the 2003 loss. As a result, the PMs urged the Auditor to apply the 2003 NPM Adjustment against the annual payment owed for 2005 and due on April 15, 2006. The Settling States countered, arguing that the PMs were not entitled to the NPM Adjustment, since each state had enacted Qualifying Statutes and each state was diligently enforcing those statutes.

On March 7, 2006, pursuant to the MSA, the Auditor issued its preliminary calculations for the PMs annual payment. Significantly, the Auditor did not apply the 2003 NPM Adjustment to the 2005 annual payment. The Auditor, however, did discuss the issue of diligent enforcement.

> The Independent Auditor has received information requesting responses from some PMs denying that

> some Settling States have "continuously had a Qualifying Statute in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due [1999-2005], and diligently enforced the provisions of such statute during such entire calendar year" (subsection IX(d)(2)(B) of the MSA). The Settling States do not agree with this position. The Independent Auditor is not charged with the responsibility under the MSA of making a determination regarding the issue. More importantly, the Independent Auditor is not qualified to make the legal determination as to whether any particular Settling State has "diligently enforced" its Qualifying Statute. Additionally, the Independent Auditor is aware of certain litigation that is ongoing related to this issue. Until such time as the parties resolve this issue or the issue is resolved by a trier of fact, the Independent Auditor will not modify its current approach to the calculation.

Independent Auditor's Notice of Preliminary Calculations for the Tobacco Litigation Master Settlement Agreement, at 5 (March 7, 2006) (emphasis added).

On March 29, 2006, the Auditor reaffirmed its position in its *Notice of Final Calculations for the Tobacco Litigation Master Settlement Agreement*

Subsection (IX(c)(1) Account Payments Due April 17, 2006. The Auditor stated:

> Additionally, the Independent Auditor has received disputes from some PMs denying that some Settling States have "continuously had a Qualifying Statute in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due [1999-2005], and diligently enforced the provisions of such statute during such entire calendar year" (subsection IX(d)(2)(B) of the MSA). The Settling States do not agree with this position. Until such time as the parties resolve this issue or the issue is resolved by a trier of fact, the Independent Auditor will not modify its current approach to the application of the NPM Settlement Adjustment.

Id. at 4-5.

On April 10, 2006, the OPMs timely served notice that they disputed the Auditor's final calculations because the Auditor did not apply the 2003 NPM Adjustment to their 2005 payments. The State of Montana (State) then filed a motion for declaratory judgment. In its motion, the State seeks to have the Court determine that the State has "diligently enforce" it's Qualifying Statutes. On May 25, 2006, the OPMs filed the current motion to compel arbitration and an unopposed request to stay the State's declaratory judgment proceedings. On the same date, the Court entered an Order staying the

proceedings until resolution of the OPMs motion to compel arbitration. The SPMs later filed their joinder to the OPM's motion on July 14, 2006.

DISCUSSION

The issue presented is whether the Auditor's determination that the 2003 NMP Adjustment does not offset the OPM's 2005 payments is an issue that must go to arbitration under Section XI(c), MSA.

The PMs argue that the plain language of Section XI(c), MSA, clearly and unambiguously require any "determination" or "calculations" made by the Auditor as arbitrable. They further argue that Montana law favors arbitration when a contract contains an arbitration clause. The State, however, contends that the MSA only provides for arbitration of "calculations" or "determinations" made by the Auditor. Because the MSA does not assign the Auditor the duty to determine whether a state is "diligently enforcing" its Qualifying Statutes and the Auditor has not made a determination as to diligent enforcement, this is not a matter for arbitration.

This dispute centers around two provisions of the MSA. First, the duties of the Auditor under Section XI(a)(1), MSA, and second, the resolution of disputes concerning "calculations" or "determinations" made by the Auditor under Section XI(c), MSA. Section XI(a)(1), MSA, in pertinent part provides that the "Independent Auditor shall calculate and determine the amount of all payments owed pursuant to this Agreement, the adjustments, reductions and offsets thereto ... the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States." Section XI(c), MSA, provides:

> Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any disputes concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the disputes shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

Included within Section XI(c) as an arbitrable dispute is the "operation" or "application" of "adjustments, reductions, offsets, carry-forwards and allocations" in Section IX(j), MSA. Significantly, Section IX(j), MSA, expressly includes the NPM Adjustment.

The Court agrees with the State that the MSA, while lengthy and specific to many issues, fails to define "diligent enforcement," or outline the standard for a Settling State to meet the "diligent enforcement" requirement. The MSA states that a Settling State is not subject to the NPM Adjustment if it has enacted a Qualifying Statute and "diligently enforced the provisions of such statute during such

entire calendar year ...." (Section IX (d)(2)(B), MSA.) However, after reading Sections XI(a)(1) and XI(c), MSA, together, it is clear that the current dispute concerning the Auditor's determination not to apply the 2003 NPM Adjustment to the 2005 annual payment is a matter for arbitration. "The whole of a contract is to be taken together so as to give effect to every part if reasonably practicable, each clause helping to interpret the other." Section 28-3-202, MCA.

Section XI(a)(1), MSA, does not expressly charge the Auditor with the duty to determine whether a state is "diligently enforcing" its Qualifying Statutes. Nevertheless, this section does state that the Auditor "shall" make all calculations and determinations as to "adjustments." Accordingly, one of the major adjustments the Auditor is to determine under the MSA is the NPM Adjustment. (Section IX(j), MSA.) Under the MSA, the NPM Adjustment applies if both of the necessary conditions are met. (Section IX(d)(1), MSA.) In this case, it is undisputed that both conditions were met. However, even if the NPM Adjustment does apply, it is negated if the Settling States "diligently enforced" their Qualifying Statutes. Thus, the issue of whether "diligent enforcement" has occurred is necessarily linked to whether the NPM Adjustment applies.

In both the March 7 and March 29, 2006, notices from the Auditor to the PMs and Settling States, it is apparent that the Auditor has not taken steps to determine whether the Settling States have or have not "diligently enforced" its Qualifying Statutes. Indeed, the Auditor acknowledges that it is not

qualified to make such a determination because it is a "legal determination."

However, the Auditor concluded that an NPM Adjustment did exist for 2003, but has refused to apply that adjustment to the PMs' 2005 annual payment. The only reasonable conclusion that can be drawn is that he Auditor has presumed that the Settling States are "diligently enforcing" their Qualifying Statues. The PMs dispute this presumption. Under Section XI(c), MSA, "any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor" is arbitrable. The Auditor's presumption of "diligent enforcement" is essentially a determination and, under Section XI(c), MSA, this determination is a matter for arbitration.

NOW, THEREFORE, IT IS ORDERED that Defendants' motion to compel arbitration under the Master Settlement Agreement **IS GRANTED.**

DATED 6th day of March, 2007.

/s/
THOMAS C. HONZEL
District Court Judge

pcs: John A. Kutzman/David R. Paoli
J. Daniel Hovan/Sara Berg/Patrick T. Fox
W. Carl Mendenhall/Sean M. Morris
William Evan Jones/Lawrence F. Daly/
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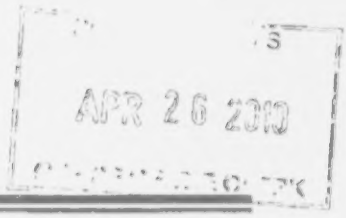

IN THE

Supreme Court of the United States

R.J. REYNOLDS TOBACCO COMPANY, ET AL.,
Petitioners,

v.

STATE OF MONTANA EX REL. STEVE BULLOCK,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR THE RESPONDENT

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April 26, 2010

QUESTION PRESENTED

Whether the Montana Supreme Court violated the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, in interpreting – consistent with generally applicable principles of Montana contract law – the plain text of an arbitration provision as not reflecting the parties' intent to arbitrate a particular issue in a settlement agreement expressly governed by state law.

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STATEMENT OF THE CASE

1. In 1998, the Attorneys General of 46 States (including Montana), the District of Columbia, the Commonwealth of Puerto Rico, and four territories – known as the "Settling States" – entered into a Master Settlement Agreement ("MSA" or "Agreement") with four major tobacco companies, R.J. Reynolds, Philip Morris, Lorillard, and Brown & Williamson Tobacco Corp.[1] The MSA is a settlement agreement, resolving litigation brought by the Settling States seeking substantial damages from tobacco companies for, among other things, their pervasive and ongoing misrepresentations to consumers regarding the health effects of smoking.

In exchange for the Settling States' release of claims against the tobacco companies, *see* MSA § XII, the tobacco companies voluntarily agreed to certain marketing restrictions, *see id.* § III, and to make annual payments to the Settling States, *see id.* § IX. The purposes of the settlement were to achieve "significant funding for the advancement of public health," to implement "important tobacco-related public health measures," and to fund "a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth." *Id.* § I.

Under the MSA, annual payments based on each tobacco company's market share, *see, e.g.*, *id.* § IX(b), are made into escrow. *See id.* § IX(a). An Independent Auditor – required by the MSA to be a "major, nationally recognized, certified public accounting firm," *id.* § XI(b) – is charged with the tasks of, among

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[1] The terms of the MSA allow for other tobacco companies subsequently to join the Agreement, which numerous tobacco companies – including certain petitioners here – have done.

other things, "calculat[ing] and determin[ing] the amount of all payments owed . . . , the adjustments, reductions and offsets thereto," and "the allocation of such payments, adjustments, reductions, offsets, and carry-forwards among" the tobacco companies and the Settling States. *Id.* § XI(a). Furthermore, disputes "arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor" are to be "submitted to binding arbitration before a panel of three neutral arbiters." *Id.* § XI(c).

Pursuant to the negotiated terms of the MSA, *see id.* § XIII, a Montana state court entered a Consent Decree and Final Judgment terminating Montana's litigation against the tobacco companies. That state court maintains a substantial role in implementing, enforcing, and interpreting the Agreement. Under the MSA, for example, the Agreement is to be "governed by the laws of the relevant Settling State." *Id.* § XVIII(n). Consistent with that governing-law provision, state courts are vested with "exclusive jurisdiction" to "implement[] and enforc[e]" the MSA. *Id.* § VII(a). In addition, the Agreement expressly authorizes Settling States to seek "a declaration construing any" provision of the MSA from the relevant state court. *Id.* § VII(c).

2. This case arises out of Montana's effort to invoke the jurisdiction of the state court to seek a declaration regarding the meaning of a provision of the MSA. In 2006, the Independent Auditor was charged with calculating and determining the amount of payments owed by the tobacco companies based on their tobacco product sales in calendar year 2005, and with recalculating and re-determining, if appropriate, the amount of payments owed by the tobacco

companies based on their tobacco product sales in prior calendar years, including 2003. With respect to the payments based on sales in 2003, the tobacco companies invoked a so-called "Non-Participating Manufacturer Adjustment." MSA § XI(d) ("NPM Adjustment"). The NPM Adjustment reflects the recognition that the obligations imposed by the MSA could reduce the market share of tobacco companies that participate in the Agreement, giving non-participating manufacturers a competitive advantage. Under the NPM Adjustment, therefore, when the market share of tobacco companies participating in the MSA declines below a certain level and the MSA is determined to be a "significant factor" in that decline, the NPM Adjustment potentially reduces annual payments to the escrow. *Id.*

An individual Settling State's share of the tobacco companies' payment, however, cannot be subjected to an NPM Adjustment if the Settling State "continuously had a Qualifying Statute . . . in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due" and if that Settling State "diligently enforced" the Qualifying Statute. *Id.* § XI(d)(2). A Qualifying Statute is a "statute, regulation, law and/or rule . . . that effectively and fully neutralizes the cost disadvantages" of the tobacco companies that participate in the MSA "vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of [the MSA]." *Id.* § XI(d)(2)(E). The MSA does not define the phrase "diligently enforced."

Because the tobacco companies submitted evidence to the Independent Auditor that they had lost the requisite market share in 2003 and that the MSA had subsequently been determined to be a "signifi-

cant factor" in that loss, they maintained that the Independent Auditor should apply the 2003 NPM Adjustment. The Settling States responded that each State had enacted a Qualifying Statute and that, because there had been no determination that a State had not diligently enforced its Qualifying Statute in 2003 (or any other year), the Independent Auditor could not apply the 2003 NPM Adjustment. The tobacco companies argued for an opposite result: the Independent Auditor must apply the 2003 NPM Adjustment in the absence of any determination that any State had diligently enforced its Qualifying Statute in 2003.

The Independent Auditor – Pricewaterhouse-Coopers – did not apply the 2003 NPM Adjustment. The Independent Auditor said that it was "not qualified to make the legal determination as to whether any particular Settling State has 'diligently enforced' its Qualifying Statute."[2] The Independent Auditor therefore refused to receive evidence from any party regarding whether any State diligently enforced its Qualifying Statute in 2003. Until that issue was resolved by the parties or another trier of fact, the 2003 NPM Adjustment would not be applied.[3]

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[2] App., *infra*, 9a-10a (Independent Auditor's Notice of Preliminary Calculations for the Tobacco Litigation Master Settlement Agreement Subsection IX(c)(1) Account Payments Due April 15, 2006, at 5 (Mar. 7, 2006) ("Independent Auditor Notice")).

[3] *See id.* The Independent Auditor's March 7, 2006 letter was a preliminary calculation. Participating manufacturer R.J. Reynolds subsequently objected to the language in the Independent Auditor's letter about the MSA not assigning the diligent-enforcement determination to the Independent Auditor and the Independent Auditor lacking the qualifications and expertise to decide that issue. Reynolds said this misstated the tobacco

3. This case began in May 2006 as a motion for declaratory order filed by the State of Montana, invoking the jurisdiction of the Montana state court that entered the consent decree. Through that motion, Montana seeks a declaration that it has enacted a valid Qualifying Statute – *i.e.*, Montana Code Annotated §§ 16-11-401 – 16-11-404 – and that it diligently enforced that provision during calendar year 2003. In filing that motion, Montana invoked the jurisdiction of its state courts to enforce the MSA, *see* MSA § VII(a)(2) (state court "shall retain exclusive jurisdiction for the purposes of implementing and enforcing" the MSA), and to issue a declaratory order interpreting "any" provision of the MSA, *id.* § VII(c)(1).

The tobacco companies responded by filing a motion to compel arbitration, relying on the arbitration provision in § XI(c) of the MSA. Although the Independent Auditor had declined to resolve definitively the diligent-enforcement issue, the tobacco companies insisted that the issue fell within the scope of the arbitration clause because the dispute was related to a calculation performed or determination made by the Independent Auditor.

The state trial court granted the motion to compel arbitration. Without invoking the Federal Arbitration Act ("FAA") or any principle of federal law, the

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companies' position and was unnecessary to the Independent Auditor's determination.

The Independent Auditor then removed that language from its final calculation. However, the Independent Auditor has never subsequently disavowed the reservations in the March 7, 2006 letter and has never said that it thinks that it does have this responsibility under the MSA or that it does have the qualifications and expertise to determine the issue.

state court concluded that arbitration of the diligent-enforcement issue was appropriate based on the text of the arbitration provision, construed in light of Montana contract law. *See* Pet. App. 39a. Despite the Independent Auditor's statement that it lacked the expertise or responsibility to decide the diligent-enforcement issue, the court found it "reasonable" to assume that the Independent Auditor had "presumed that the Settling States are 'diligently enforcing' their Qualifying Statutes." *Id.* at 40a.

4. The Montana Supreme Court, by a four-to-one vote, reversed. Although recognizing that "[a]rbitration is a matter of contract," the Montana Supreme Court first canvassed this Court's federal arbitration precedent. Pet. App. 10a-11a; *see also id.* (acknowledging that "the law favors arbitration when a contract contains an arbitration clause"). Based on *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), the Montana Supreme Court explained that "the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate *that dispute*." Pet. App. 11a. And, relying on this Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the court went on to hold that, "[w]hen deciding whether the parties agreed to arbitrate a certain matter, courts generally should apply ordinary state-law principles that govern the formation of contracts." Pet. App. 11a. That principle, the court said, was in perfect accord with the MSA, which provides that the "'the laws of the relevant Settling State'" "'shall'" govern the Agreement. *Id.* (quoting MSA § XVIII(n)).

The Montana Supreme Court then proceeded to decide, "[u]nder Montana law," whether the arbitra-

tion provision encompassed the diligent-enforcement issue raised by the State's motion. *Id.* at 11a-12a. Reviewing the arbitration provision, the court first found it necessary to "identify the parties' 'dispute, controversy or claim.'" *Id.* at 12a (quoting MSA § XI(c)). On that score, the court held that the tobacco companies had framed the issue raised by the State's motion in "imprecise terms." *Id.* at 13a. The dispute is fundamentally not about whether to apply the NPM Adjustment, the court reasoned, because the State's motion seeks only to litigate the meaning of diligent enforcement and the Independent Auditor had "concluded that it was neither responsible nor qualified to determine diligent enforcement." *Id.* The court, moreover, noted that the motion did not seek "to challenge any calculation, determination, or course of action actually performed, made, or chosen by the Independent Auditor," but rather sought a "declaration that Montana had, in fact, diligently enforced [the Qualifying Statute] during 2003." *Id.* at 14a. The court therefore rejected the tobacco companies' efforts to "repackage" the dispute "as something it clearly is not." *Id.*

The Montana Supreme Court further concluded that the dispute is not one "'arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor.'" *Id.* (quoting MSA § XI(c)). The dispute does not relate to a calculation or determination, the court explained, because the Independent Auditor had, at most, *presumed* that Montana diligently enforced the Qualifying Statute. In ordinary usage, the court reasoned, a presumption is not a "calculation or determination" because those words denote some type of affirmative investigation. *Id.* at 14a-15a. The court also explained that the

dispute does not "arise out of or relate to" any calculation or determination performed or made by the Independent Auditor because Montana's motion "relates to an issue (diligent enforcement) that the Independent Auditor explicitly refused to determine." *Id.* at 15a.[4]

The Montana Supreme Court refused to depart from its reading of the plain text of the provision based on the policy concern that, without a single arbitration, "'chaos'" would ensue. *Id.* at 17a. The court reiterated that the text of the provision was "plain" and that under "Montana law" the court must give effect to the plain text, not to policy concerns. *Id.* at 17a-18a. The court also noted that uniformity concerns were "undercut" by the fact that the MSA made the law of each Settling State the governing law, *id.* at 18a, and because Montana courts would be competent to apply a uniform standard were such a standard ever developed, *see id.* at 19a.

Finally, the Montana Supreme Court acknowledged that other forums, applying the contract law of the relevant Settling State, had interpreted the MSA's arbitration provision differently. *See id.* Those decisions, however, were of limited value because the question before the court was the dispute as framed by Montana's motion and because interpreting the meaning of the words of the MSA's arbitration provision was a question of "Montana law." *Id.*

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[4] That analysis was not changed, the court held, by certain parenthetical language in the provision. *See* Pet. App. 16a. Applying the principle of state law that contracts should be interpreted as a whole, the court explained that reading that language to mean that any dispute remotely connected to the NPM Adjustment must be arbitrated would "nullify the limiting words 'calculations performed by, or any determinations made by,' the Independent Auditor." *Id.*

Justice Rice dissented. He believed "interpretational errors" led the majority improperly to conclude that the text of the arbitration provision excluded the dispute about diligent enforcement. *Id.* at 26a.

The tobacco companies filed a petition for rehearing, which the Montana Supreme Court denied. *See id.* at 28a-31a.

REASONS FOR DENYING THE WRIT

I. CERTIORARI IS NOT WARRANTED BECAUSE THE MONTANA SUPREME COURT DID NOT VIOLATE THE FAA

In the decision below, the Montana Supreme Court held that the MSA's arbitration provision did not reflect the parties' intent to arbitrate the issue of diligent enforcement raised by Montana's motion. This Court's review of that case-specific contractual interpretation is unwarranted. First, the question decided was one of state law, and any error likewise was one of state law. Beyond that, the Montana Supreme Court appropriately applied FAA precedent in resolving this question. Indeed, the absence of any substantial question as to whether the decision below "violates" the FAA deprives this Court of jurisdiction under 28 U.S.C. § 1257(a). Setting aside those fundamental defects in the petition, this Court should deny the tobacco companies' request for review because the Montana Supreme Court's interpretation of the arbitration provision is correct. Finally, the decisions of other jurisdictions do not establish the need for this Court's intervention here.

A. Whether the Parties to the MSA Agreed To Arbitrate Diligent Enforcement Is a Matter of State Law Not Appropriately Resolved by This Court

The legal issue raised by the petition – whether the parties to the MSA agreed to arbitrate diligent enforcement – is a narrow question of state-law contract interpretation. Applying generally applicable state contract law against a backdrop of general FAA principles (*see infra* Part I.B.2), the court below concluded that the parties had not agreed to arbitrate the diligent-enforcement issue – and only that issue. *See* Pet. App. 17a ("plain language of the arbitration provision" does not apply to diligent enforcement). The tobacco companies maintain that the court erred in so interpreting the arbitration provision, *see*, *e.g.*, Pet. 3 ("dispute over 'diligent enforcement' under the MSA clearly falls within the plain language of the MSA's broad arbitration provision"), and they seek this Court's review to correct that error. But this Court must deny the petition at the threshold: whether the parties agreed to arbitrate diligent enforcement is a matter of state contract, not federal arbitration, law, and this Court does not sit to review such decisions.

The FAA does establish certain federal rules governing arbitration agreements, but it does not require arbitration in every given case. The FAA's "basic purpose . . . is to overcome courts' refusals to enforce agreements to arbitrate," *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270 (1995), by placing arbitration agreements "upon the same footing as other contracts." H.R. Rep. No. 68-96, at 1 (1924); *see Mitsubishi Motors*, 473 U.S. at 626 (federal arbitration policy "is at bottom a policy guaranteeing the enforcement of private contractual arrange-

ments"). The FAA accordingly preempts the application of state statutes or common-law rules that would otherwise bar the enforcement of arbitration agreements as well as state laws that single out such agreements for suspect status. *See, e.g., Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).[5] Furthermore, the FAA, this Court has said, embodies an extra-statutory presumption in favor of arbitrability when an arbitration agreement is ambiguous. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995).

Despite the FAA's displacement of state law in those certain respects, however, "the FAA does not require parties to arbitrate when they have not agreed to do so." *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 478 (1989); *see EEOC v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002) ("nothing in the [FAA] authorizes a court to compel arbitration of any issues . . . that are not already covered by the agreement"); *Atkinson v. Sinclair Ref. Co.*, 370 U.S. 238, 241 (1962). As far as the FAA is concerned, then, parties are free to agree to arbitrate some issues, all issues, or no issues at all. *See Mastrobuono*, 514 U.S. at 57 ("courts are bound to interpret contracts in accordance with expressed intentions of the parties – even if the effect of those intentions is to limit arbitration"); *Mitsubishi Motors*, 473 U.S. at 626 ("as with any other contract, the parties' intentions control").

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[5] Even this rule is limited: generally applicable state-law defenses that do not single out arbitration agreements may be applied "to invalidate arbitration agreements without contravening [the FAA]." *Casarotto*, 517 U.S at 687; *see id.* ("Courts may not . . invalidate arbitration agreements under state laws applicable only to arbitration provisions.").

The first question underlying the interpretation of any arbitration agreement, therefore, is whether the parties intended the particular dispute to be arbitrated. Resolution of that threshold issue of the parties' intent is a matter of state, not federal, law. As this Court has said, "[w]hen deciding whether the parties agreed to arbitrate a certain matter . . . courts generally . . . should apply ordinary state-law principles that govern the formation of contracts." *Kaplan*, 514 U.S. at 944. This principle is longstanding. *See, e.g., Mastrobuono*, 514 U.S. at 62-63 & n.9 (relying on Illinois and New York contract law in interpreting scope of arbitration provision); *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) ("state law . . . is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally"). It was recently reaffirmed by this Court. *See Arthur Andersen LLP v. Carlisle*, 129 S. Ct. 1896, 1901-02 (2009) (neither § 2 nor § 3 of the FAA "purports to alter background principles of state contract law regarding the scope of agreements"; "state law . . . is applicable to determine which contracts are binding under § 2 and enforceable under § 3") (internal quotation marks and alterations omitted).

Leading authorities confirm that the question of arbitrability is a matter of state contract law: "[s]ince arbitration agreements are contracts, their meaning must be determined by applying rules of state contract law." 1 Domke on Commercial Arbitration § 15:1 (updated Aug. 2009); *see Avedon Eng'g, Inc. v. Seatex*, 126 F.3d 1279, 1287 (10th Cir. 1997) ("We look to state law principles of contract formation to tell us whether an agreement to arbitrate has been reached."); *cf. Vaden v. Discover Bank*, 129 S.

Ct. 1262, 1271-72 (2009) (agreeing that questions such as "What issues does [an] agreement [to arbitrate] encompass?" are "principally contractual questions"). And, even were there doubt on this issue (and there is none), the MSA conclusively dispels any such doubt in this case by stating that "[t]his Agreement . . . shall be governed by the laws of the relevant Settling State." MSA § XVIII(n).

A straightforward application of those principles compels denial of the tobacco companies' certiorari petition. As this Court emphasized in *Volt*, "this Court does not sit to review" "interpretation of private contracts," which is "ordinarily a question of state law." 489 U.S. at 474. That practice reflects that, in our federalist system, "state courts are the ultimate expositors of state law." *Mullaney v. Wilbur*, 421 U.S. 684, 691 (1975); *see also Murdock v. City of Memphis*, 87 U.S. (20 Wall.) 590, 626 (1875) ("The State courts are the appropriate tribunals, as this court has repeatedly held, for the decision of questions arising under their local law, whether statutory or otherwise."); *Schad v. Arizona*, 501 U.S. 624, 636 (1991) (it is a "fundamental principle that [this Court is] not free to substitute [its] own interpretations of state statutes for those of a State's courts"); *cf. Railroad Comm'n v. Pullman Co.*, 312 U.S. 496, 499-500 (1941); *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

Indeed, this case is on all fours with *Volt*. In that case, this Court held that the application of a California statute permitting a stay of arbitration pending resolution of related litigation was not "pre-empted by the [FAA] in a case where the parties ha[d] agreed that their arbitration agreement w[ould] be governed by the law of California." 489 U.S. at

470-71. On its way to making that principal holding, however, this Court refused to review a threshold interpretive issue decided by a state court – namely, that a choice-of-law clause "incorporated the California rules of arbitration [including a stay provision] into their arbitration agreement." *Id.* at 473. In so doing, this Court explained that the "interpretation of private contracts" – even arbitration agreements – "is ordinarily a question of state law, which [it] does not sit to review." *Id.* at 474-76. This Court subsequently has reaffirmed that core principle of *Volt*. *See Preston v. Ferrer*, 552 U.S. 346, 360 (2008) (noting that, in *Volt*, this Court "rel[ied] on the [California] Court of Appeal's interpretation" of the arbitration agreement); *Mastrobuono*, 514 U.S. at 60 n.4 (noting that, in *Volt*, this Court "did not interpret the contract *de novo*" but "instead . . . deferred to the California court's construction of its own State's law").[6]

Volt controls this case. The dispute here, as in *Volt*, is a garden-variety contract question of the parties' intent regarding arbitrability. In *Volt*, the issue was whether the parties intended to incorporate a

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[6] Although *Volt* has been narrowed in certain respects, *see, e.g.*, *Mastrobuono*, 514 U.S. at 58-59, those subsequent decisions are not relevant to the proposition relevant here – namely, that this Court does not sit to review state-court interpretations of arbitration agreements. In *Mastrobuono*, this Court did interpret an arbitration agreement, but that case arose in federal court and the Court stressed that that distinction was dispositive. *See id.* at 60 n.3. Furthermore, this Court applied state law in interpreting the arbitration agreement in *Mastrobuono*, confirming that the meaning of such agreements is a matter of state, not federal, law. *See id.* at 62-63 & n.9. Petitioners – although citing *Volt* in their petition – do not ask this Court to overrule *Volt*, and they therefore have waived any such request. *See* Sup. Ct. R. 14.1(a); *Yee v. City of Escondido*, 503 U.S. 519, 535 (1992).

provision precluding arbitration pending resolution of related litigation. Here, the issue is whether the parties intended diligent enforcement to be arbitrated. Just as this Court declined to review a state court's interpretation of the arbitration agreement in *Volt*, it should do the same here. Indeed, the tobacco companies' arguments for this Court's review track precisely the arguments made by the *dissent* in *Volt*. *Compare* Pet. 17 ("If courts were free to thwart arbitration by giving arbitration provisions an artificially narrow interpretation under state law, the FAA would be entirely hortatory.") *with Volt*, 489 U.S. at 481-82 (Brennan, J., dissenting) ("in order to guard against arbitrary denials of federal claims, a state court's construction of a contract in such a way as to preclude enforcement of a federal right is not immune from review in this Court as to its adequacy") (internal quotation marks omitted); *and* Pet. 26 ("By refusing to enforce the MSA's arbitration provision according to its plain terms, the Montana Supreme Court deprived the parties of their federal arbitration rights.") *with Volt*, 489 U.S. at 484 (Brennan, J., dissenting) ("the right of the instant parties to have their arbitration agreement enforced pursuant to the FAA could readily be circumvented by a state-court construction of their contract").[7]

That this Court has said that the FAA creates a "substantive" body of federal law does not, as the

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[7] The tobacco companies incorrectly insinuate that this Court's observation that arbitration agreements are to be enforced "'in accordance with their terms,'" Pet. 16 (quoting *Volt*, 489 U.S. at 478); *see also* Pet. 4, reflects an intent to federalize the meaning of every word in an arbitration agreement. But *Volt*, *Kaplan*, *Perry*, and *Mastrobuono* establish unmistakably that ascertaining parties' intent with respect to arbitrability is a matter of state, not federal, law.

tobacco companies argue (at 16), render this Court's review of the Montana Supreme Court's decision appropriate. The language the tobacco companies cite reflects this Court's view that, because the FAA is substantive, and not purely procedural, it is enforceable in state and federal court. *See, e.g.*, *Perry*, 482 U.S. at 489 (FAA creates a "body of substantive law" that is "enforceable in both state and federal courts"). *But see Preston*, 552 U.S. at 363 (Thomas, J., dissenting) (reaffirming his oft-stated position that the FAA "does not apply to proceedings in state courts"). Similarly, language cited by the tobacco companies from *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), reflects nothing more than the FAA's presumption in favor of arbitration is federal in nature and that, in that case, this federal character weighed against a "surrender of jurisdiction" through abstention. *Id.* at 25-26; *see also Arthur Andersen*, 129 S. Ct. at 1902 n.5 (language of *Moses H. Cone* cited here is little more than a "vague prescription"). That language does not mean that ascertaining the parties' intent regarding the scope of an arbitration clause is a question of federal, rather than state, law. *Volt*, *Kaplan*, *Perry*, and *Mastrobuono* conclusively foreclose that view.[8]

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[8] The tobacco companies suggest that the dissent in *Volt* "agree[d]" with the majority that the interpretation of an arbitration provision is a "question of federal law." Pet. 16 (internal quotation marks omitted). But the majority in *Volt* plainly declined to review the state court's interpretation of the arbitration agreement, *see* 489 U.S. at 474-76, as this Court has since confirmed, *see Mastrobuono*, 514 U.S. at 60 n.4. And the *Volt* dissent itself emphasized that the majority "decline[d] to review" the state court's construction of the agreement "apparently because it f[ound] no question of federal law involved." 489 U.S. at 481; *see id.* ("[c]ontrary to the Court's view, the state

B. The Montana Supreme Court Properly Applied the FAA and Correctly Interpreted the MSA's Arbitration Clause

This Court's review also is unwarranted because the Montana Supreme Court did not "[v]iolate[]" the FAA and it correctly interpreted the MSA's arbitration provision.

1. The Decision Below Did Not Violate the FAA

The centerpiece of the petition is the tobacco companies' claim that the decision below "[v]iolate[s]" or "squarely conflicts" with the FAA. Pet. 15; *see* Pet. i (question presented is "[w]hether the Montana Supreme Court violated" the FAA). But this argument both misconceives the obligations imposed by the FAA and misdescribes the opinion of the Montana Supreme Court.

Interpreting an arbitration agreement as not encompassing a particular issue does not "[v]iolate[]" the FAA. The FAA does not compel arbitration against the wishes of the contracting parties: because "[a]rbitration under the [FAA] is a matter of consent, not coercion," parties are free to agree to arbitrate any, all, or no issues. *Volt*, 489 U.S. at 479. Instead, the FAA precludes States from refusing to enforce arbitration agreements; it prohibits States from relegating arbitration agreements to a suspect status under state law; and it creates a presumption that ambiguities should be resolved in favor of arbitration. *See supra* Part I.A.

The decision below is fully consistent with these principles. Contrary to the tobacco companies' assertion (at 18) that "the Montana Supreme Court

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court's" contract interpretation "is reviewable for two independent reasons").

refused to apply the federal substantive law of arbitrability – or even to acknowledge its existence," the lead paragraph of the discussion section of the opinion cites no less than three decisions of this Court interpreting and applying the FAA. *See* Pet. App. 10a (citing *AT&T Techs., Inc. v. Communications Workers*, 475 U.S. 643 (1986), *Mitsubishi Motors*, and *Kaplan*).[9] After citing that FAA precedent, the Montana court explained that, "[w]hen deciding whether the parties agreed to arbitrate a certain matter, courts generally should apply ordinary state-law principles that govern the formation of contracts." *Id.* at 11a (citing *Kaplan*). The court then applied generally applicable state contract law to the arbitration provision, concluding that the parties to the MSA did not agree to arbitrate diligent enforcement. *See id.* at 11a-18a. The court accordingly did not refuse to recognize the "valid[ity], irrevocab[ility], and enforceab[ility]" of an arbitration agreement. 9 U.S.C. § 2. Nor did it apply a state law that singled out arbitration agreements for special scrutiny. It simply held that the arbitration agreement *did not apply* by its plain terms to the dispute before it. The FAA demands nothing more.

It is therefore not surprising that the tobacco companies do not point to a *single* part of the opinion that disavows any federal policy or law. Petitioners'

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[9] The tobacco companies accordingly are wrong in claiming that "the majority opinion below is written as if the FAA did not exist." Pet. 24. As explained, the Montana Supreme Court cited ample federal FAA precedent, even though its failure to do so would not have supported an inference that it failed to follow relevant federal law. *See Bell v. Cone*, 543 U.S. 447, 455 (2005) ("Federal courts are not free to presume that a state court did not comply with constitutional dictates on the basis of nothing more than a lack of citation.")

argument instead reduces to the claim that the Montana court misinterpreted the text of the arbitration provision. *See* Pet. 18-26. But any such error would be one of state law – which "this Court does not sit to review," *Volt*, 489 U.S. at 474 – and it does not "[v]iolate[]" the FAA to find that parties did not intend to arbitrate a dispute. The FAA does not guarantee the arbitration of any particular issue, "it does not require parties to arbitrate when they have not agreed to do so . . . [,] nor does it prevent parties who do not agree to arbitrate from excluding certain claims from the scope of their arbitration agreement." *Id.* at 478; *see Mitsubishi Motors*, 473 U.S. at 628; *Mastrobuono*, 514 U.S. at 57; *Waffle House*, 534 U.S. at 293-94.[10]

The closest the tobacco companies come to suggesting *how* the decision below violated the FAA is in contending that the Montana court disregarded the rule that "doubts" should be "resolve[d] . . . in favor of arbitration." Pet. 15 (emphasis omitted); *see* Pet. 24 ("Nor could or did the majority explain how its interpretation of the MSA's arbitration provision comported with the *federal* presumption in favor of arbitration."). But, here again, the tobacco companies point to no language in the opinion disclaiming or

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[10] For these reasons, the Montana Supreme Court did not, contrary to the tobacco companies' assertion, "apply 'Montana law' to *override* the plain terms of an arbitration agreement," Pet. 24 (emphasis added); *see* Pet. 26 (the court "refused to enforce the MSA's arbitration provision according to its plain terms"). Rather, the court below applied Montana law to *interpret* the plain terms of an arbitration agreement. The tobacco companies' disagreement with that construction of the arbitration provision does not establish a "[v]iolat[ion]" of the FAA. Again, any such error would be one of state, not federal, law. *See supra* Part I.A.

countermanding this interpretive principle. And with good reason. The presumption in favor of arbitration applies when an arbitration agreement is "ambigu[ous]." *Volt*, 489 U.S. at 476 ("due regard" should be given to policy favoring arbitration by "resolv[ing]" "ambiguities" in favor of arbitration); *Waffle House*, 534 U.S. at 289 (notwithstanding federal policy favoring arbitration, "[a]bsent some ambiguity in the agreement . . . it is the language of the contract that defines the scope of disputes subject to arbitration").

The Montana Supreme Court acknowledged this presumption. *See, e.g.*, Pet. App. 9a. But the court concluded that the MSA's arbitration provision was "clear." *Id.* at 15a; *see id.* at 16a-17a ("read as a whole, it is clear that the parties intended to arbitrate only those disputes which involve calculations performed or determinations made by the Independent Auditor"); *id.* at 17a-18a (rejecting policy arguments as basis for disregarding "plain language of the arbitration provision"). Based on that threshold textual determination, the presumption in favor arbitration was inapplicable. *See Waffle House*, 534 U.S. at 294 ("Because the FAA is at bottom a policy guaranteeing the enforcement of private contractual arrangements, we look first to whether the parties agreed to arbitrate a dispute, not to general policy goals, to determine the scope of the agreement. While ambiguities in the language of the agreement should be resolved in favor of arbitration, we do not override the clear intent of the parties, or reach a result inconsistent with the plain text of the contract, simply because the policy favoring arbitration is implicated.") (internal quotation marks and citations omitted); *see also Connecticut Nat'l Bank v. Germain*,

503 U.S. 249, 254 (1992) ("When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete.").[11]

In all events, nothing in the text of the opinion supports the tobacco companies' accusation that the Montana Supreme Court flouted the presumption in favor of arbitration. And, absent "affirmative indication to the contrary," this Court must presume that the Montana court "followed" relevant FAA precedent. *Moses H. Cone*, 543 U.S. at 455; *see Woodford v. Visciotti*, 537 U.S. 19, 24 (2002) (citing "presumption that state courts know and follow the law").

In short, this is not a case in which a state court has held that a state law overrides an obligation imposed by the FAA. *See, e.g., Preston*, 552 U.S. at 349 (FAA preempts state law giving primary jurisdiction to agency to decide issues that parties agreed to arbitrate). Nor is it a case in which a state court has applied an arbitration-specific rule to defeat an otherwise applicable arbitration agreement. *See, e.g., Allied-Bruce Terminix*, 513 U.S. at 269-70 (FAA preempts application of statute barring enforcement of pre-dispute arbitration agreements); *Casarotto*, 517 U.S. at 683 (FAA preempts state statute singling out arbitration agreements for special notice requirements). Instead, this is a case where a state court – citing and applying relevant federal precedent as well as generally applicable state contract law – held

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[11] The conclusion that the MSA's arbitration provision is unambiguous is the correct interpretation of the agreement's text (notwithstanding the decisions of other jurisdictions), as discussed below. *See infra* Part I.B.2. But any error by the Montana Supreme Court in deciding whether the provision was unambiguous would be one of state contract, not federal arbitration, law. *See supra* Part I.A.

that an arbitration agreement unambiguously did not encompass the dispute before it. The tobacco companies cite *no* authority suggesting a violation of the FAA in such circumstances.

Indeed, given the presumption that state courts know and apply federal law, the Montana Supreme Court's citation to relevant federal authority, and the tobacco companies' conspicuous failure to identify *any* part of the decision below disavowing any federal arbitration rule, the petition presents no substantial federal question over which this Court has jurisdiction. *See* 28 U.S.C. § 1257(a); Eugene Gressman *et al.*, *Supreme Court Practice* § 3.16, at 181 (9th ed. 2007) (collecting authority for proposition that federal question raised must be substantial and not frivolous to support an exercise of jurisdiction under 28 U.S.C. § 1257(a)). The tobacco companies' complaint that the Montana court erred in reading the text of the arbitration provision as unambiguously not applying to diligent enforcement raises a question of state law outside this Court's jurisdiction.

2. The Montana Supreme Court Correctly Interpreted the Arbitration Provision

Even if this Court had jurisdiction to review the Montana Supreme Court's interpretation of this particular contract, this Court should deny the petition because the Montana court correctly held that the parties to the MSA did not agree to arbitrate diligent enforcement.

The decision below properly begins – and ends – its analysis with the text of the arbitration provision. The arbitration provision provides, in relevant part, that "[a]ny dispute . . . arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, with-

out limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(j)) shall be arbitrated." MSA § XI(c). As the Montana court correctly observed, the text focuses on the nature of the "dispute" and on whether that dispute concerns a "determination made" or "calculation performed" by the Independent Auditor. *See* Pet. App. 13a-16a.

In ascertaining the nature of the dispute underlying this litigation, the Montana court properly concluded that the tobacco companies had "frame[d]" the dispute in "imprecise terms." *Id.* at 13a. The court explained – and the tobacco companies do not contest here – that "[t]he State filed the instant action not to challenge any calculation, determination, or course of action actually performed, made, or chosen by the Independent Auditor." *Id.* at 14a. Instead, "the State sought a declaration that Montana had, in fact, diligently enforced" its Qualifying Statute in calendar year 2003. *Id.* The Montana court therefore properly rejected the tobacco companies' characterization of this litigation as a dispute over "the Independent Auditor's decision to presume diligent enforcement rather than presume no diligent enforcement." *Id.* at 13a.

Furthermore, and again interpreting the plain text of the arbitration provision, the Montana court concluded that "[t]he Independent Auditor neither 'calculated' nor 'determined' whether Montana diligently enforced a Qualifying Statute." *Id.* at 14a. That was so, the court reasoned, because the Independent Auditor *declined* to decide the issue of diligent enforcement, finding the issue beyond its responsibilities under the MSA and its ken. *See id.* at 13a. The to-

bacco companies do not dispute that reasoning here. Nor could they, as that description of the Independent Auditor's actions is correct. *See* App., *infra*, 9a-10a (Independent Auditor Notice at 5) (explaining that it had no responsibility to make a diligent enforcement "determination" and that it was not qualified to make such a "determination"). And, because "the Independent Auditor explicitly refused to determine" the issue of diligent enforcement, the court was right to conclude that the State's motion did not "arise[] out of or relate[] to" any payment determination made by the Auditor. Pet. App. 15a (internal quotation marks omitted). The tobacco companies' contrary arguments before this Court simply elide these crucial aspects of the decision below.[12]

The Montana court's reading of the arbitration provision also properly construes the MSA as a whole. As explained above, the MSA assigns state courts a substantial role in implementing, enforcing, and interpreting the Agreement. *See supra* p. 2. In particular, the Montana court has "exclusive jurisdiction" to "implement[] and enforc[e]" the Agreement, MSA § VII(a), and is expressly authorized to issue "a

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[12] Petitioners' criticisms of the decision fail to accord any deference to the contract interpretation of Montana's highest court. Even the dissent in *Volt* would have employed a "narrow" standard of review in interpreting the arbitration agreement, 489 U.S. at 484 n.6, yet the petition here proceeds as if *no* deference is due. Indeed, the petition goes so far as to suggest that "summary reversal is warranted." Pet. 32. That request has no merit. Because the ultimate issue in this case is whether the text of an arbitration agreement evidences an intent that diligent enforcement be arbitrated, summary reversal would squarely conflict with *Volt*, *Kaplan*, *Perry*, and *Mastrobuono*; it would countermand the presumption that state courts know and follow the law; and it would mock the principle that state courts are the ultimate arbiters of state law.

declaration construing any" provision of the MSA, *id.* § VII(c). This case began with the State seeking to invoke the jurisdiction of a state court to issue a declaration construing a provision of the MSA, which the State is expressly permitted to do under the Agreement. Indeed, state-court jurisdiction makes sense here given that the issue is a state-law question of what amounts to "diligent" enforcement of a statute, which will vary from State to State. The tobacco companies' expansive view of the arbitration provision therefore conflicts with the contract as a whole. *Accord* Pet. App. 16a (noting Montana contract-law principle that "the whole of a contract is to be taken together") (internal quotation marks and alterations omitted).

C. The Decisions of Other Jurisdictions Provide No Basis for This Court's Review

The tobacco companies incorrectly assert that a so-called "lopsided conflict between the Montana Supreme Court and the courts of every other jurisdiction" to have decided the "precise issue" presented here warrants this Court's review. Pet. 3.

First, the decision below poses no conflict of federal law with the decisions of other jurisdictions. The issue here is whether, under Montana law, *see* MSA § XVIII(n), Pet. App. 17a, the State's motion raises an issue that must be arbitrated under the MSA. The other decisions cited by the tobacco companies similarly were based ultimately on the contract laws of each State, as well as the specific issues raised in the litigation filings by each State. *See, e.g.*, *Alabama v. Lorillard Tobacco Co.*, 1 So. 3d 1, 7 (Ala. 2008) ("It is well established that the interpretation of an arbitration agreement within the scope of the Federal Arbitration Act is governed by general state-law

principles of contract interpretation.") (internal quotation marks and alterations omitted); *Ohio v. Philip Morris, Inc.*, No. 06AP-1012, 2008 OHIO APP LEXIS 3262, at *26 (Ohio Ct. App. July 24, 2008) ("Pursuant to the MSA's plain language, we apply Ohio law to our resolution of this appeal."). Because each court was applying a different body of *state* law to the issue as presented in litigation filings by each State, there can be no genuine "conflict" on this question, much less a conflict of *federal* law. *See, e.g.*, Gressman, *Supreme Court Practice* § 4.9, at 259 (to be relevant to certiorari, conflict among state high courts must "concern[] a federal question").

Second, the tobacco companies' suggestion that these decisions represent a uniform and "unbroken line of authority" that contradicts the Montana Supreme Court is unfounded. Pet. 23. By our tally, 31 of the referenced decisions make *no* or only quick reference to federal arbitration law; in some cases, that reference simply is to illustrate the consistency of state and federal law (Alaska, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Iowa, Massachusetts, Michigan, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, and Washington). Three cases decided the issue procedurally and/or the issue was abandoned on appeal (Kentucky, Maine, and West Virginia). And 13 cases discuss federal-law arbitration principles in addition to state-law contract principles (Alabama, Arizona, Georgia, Kansas, Louisiana, Maryland, Missouri, Nebraska, Nevada, North Dakota, Oklahoma, Puerto Rico, South Dakota, and Wisconsin). The one thing

that *is* uniform about the decisions (with the exception of Puerto Rico), therefore, is the recognition that the issue of whether the parties agreed to arbitrate diligent enforcement is ultimately a matter of *state* contract, not federal arbitration, law.

II. WHETHER THE MONTANA SUPREME COURT CORRECTLY INTERPRETED THE MSA'S ARBITRATION PROVISION PRESENTS NO ISSUE WORTHY OF THIS COURT'S REVIEW

Setting aside the foregoing substantial grounds for rejecting the petition, this Court's review is unwarranted because the case-specific question of contract interpretation presented is narrow and unlikely to recur; this case offers no vehicle to redress the tobacco companies' exaggerated claims regarding the alleged "death" of arbitration in Montana; and the tobacco companies' stated concerns with uniformity under the MSA are misplaced.

A. The Issue Presented Is Exceptionally Narrow and Will Not Recur

This Court's intervention is unwarranted because the question presented is limited and case-specific. The ultimate issue is whether the parties to the MSA agreed to arbitrate the issue of diligent enforcement raised by Montana's motion. That question, consistent with this Court's well-settled precedent in *Volt*, *Kaplan*, *Perry*, and *Mastrobuono*, would be resolved under Montana law. *See supra* Part I.A. And the procedural posture of this case – a motion for declaratory ruling invoking the jurisdiction of a state court to interpret and enforce an agreement governed by state law – is highly unusual. For those reasons, any merits decision by this Court favorable to the tobacco companies would be exceptionally narrow and case-specific. The Court would hold at most that, as

a matter of Montana law, the parties to the MSA agreed to arbitrate diligent enforcement. *See*, *e.g.*, Pet. 3 ("a dispute over 'diligent enforcement' under the MSA clearly falls within the plain language of the MSA's broad arbitration provision"). Such a decision would provide no occasion to fashion broad rules under the FAA. In fact, because this case fundamentally is one of contract interpretation, a decision in favor of the tobacco companies would have *no* application beyond the circumstances of this case. *Cf. Mastrobuono*, 514 U.S. at 72 (Thomas, J., dissenting) ("the majority's interpretation of the contract represents only the understanding of a single federal court regarding the requirements imposed by state law" and, "[a]s such, the majority's opinion has applicability only to this specific contract and to no other").

Furthermore, even the narrow issue of the arbitrability of diligent enforcement is virtually certain not to recur. By the tobacco companies' admission, the courts of the 47 other affected jurisdictions *already* have decided the issue. *See* Pet. 3; *see also* Pet. 18-23. Accordingly, not only is this Court's review unnecessary because the decision below is simply an "outlier" – as the tobacco companies put it (at 3), but there also is no chance that any error in the Montana court's interpretation of the MSA will influence future courts. Indeed, because the arbitrability of diligent enforcement now has been decided by all relevant jurisdictions, this issue likely will *never* be addressed by any court again. In these unique circumstances, the petition cannot possibly satisfy this Court's traditional standards for certiorari. *See* Gressman, *Supreme Court Practice* § 4.4(a), at 245 ("recurring nature of the issue in conflict often plays a decisive role in the grant or denial of certiorari").

B. The Alleged Hostility of the Montana Supreme Court to Arbitration Is No Basis for This Court's Review

In an effort to divert attention from the fact that the issue presented is narrow and unlikely to recur, the tobacco companies invite this Court's review to remedy "[t]he Montana Supreme Court's ongoing war against arbitration." Pet. 29 (internal quotation marks omitted). That hyperbole is quite wide of the mark.

First, the tobacco companies' narrative of hostility by the Montana Supreme Court to federal arbitration law has no basis in fact. Since *Casarotto*, the Montana Supreme Court has applied and enforced the FAA and this Court's arbitration precedent. *See, e.g.*, *Martz v. Beneficial Montana, Inc.*, 135 P.3d 790, 794 (Mont. 2006) (applying FAA and this Court's decisions in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), to uphold a motion to compel arbitration). Petitioners thus speak with false and prematurely expressed overstatement in contending that "'arbitration is dead in Montana.'" Pet. 32 (quoting Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139, 177 (2005)). Indeed, petitioners' exaggerated claim is based on a law review article discussing a 2002 decision – *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1 (Mont. 2002) – that this Court declined to review, *see* 538 U.S. 956 (2003). *Kloss*, moreover, involved whether a state-law rule that waivers of constitutional rights must be knowing and voluntary could be applied as a generally applicable defense to defeat application of an arbitration agreement. *See* 54 P.3d

at 146-47. This case has nothing to do with that question and therefore could not possibly be a vehicle to redress *Kloss*'s effect (if any) on arbitration in Montana. That point serves only to underscore that the narrow issue raised here means that this case could not possibly be a vehicle for this Court to fashion any rules of federal arbitration law broader than the specific contract and facts presented.

Second, a decision to grant or deny certiorari should turn not on past decisions (*see* Pet. 29-31 & n.2) – which have *nothing* to do with the question presented here – but on whether the decision below satisfies this Court's criteria for certiorari. Whatever might be said about past decisions from more than a decade ago, the decision below exhibits no animus to federal arbitration policy. In its opinion, the Montana Supreme Court states that its decision is "based on Montana law and the plain language of the arbitration provision," Pet. App. 17a; *see id.* at 19a-20a, and it cites and applies federal arbitration precedent, *see id.* at 10a-11a. Nothing in the opinion exhibits any hostility toward federal arbitration law. In light of the plain text of the opinion and this Court's presumption that "state court[s]" are "competent to apply federal law," *Empire Healthchoice Assur., Inc. v. McVeigh*, 547 U.S. 677, 701 (2006); *see Visciotti*, 537 U.S. at 24, the tobacco companies' efforts to impugn the motives and integrity of four Justices of the Montana Supreme Court based on a small number of law review articles should be rejected out of hand.

C. The Tobacco Companies' Claim That the Decision Below Frustrates the Implementation of the MSA Is Misplaced

In a final gambit to secure this Court's review, the tobacco companies argue that allowing the Montana Supreme Court's interpretation of the arbitration provision to stand could "balkanize[]" the MSA, resulting in "chaos" and disuniformity. Pet. 28. This argument may be quickly rejected.

First, the tobacco companies' balkanization fear is now largely moot. "Courts in 47 of the 48 affected jurisdictions" have already decided that diligent enforcement is arbitrable. Pet. 3; *see id.* (Montana "is the lone outlier"). And the tobacco companies cannot possibly suggest that there will be any crippling disuniformity in the MSA by having a Montana court decide the issue of diligent enforcement of *Montana's* Qualifying Statute, especially because "Montana's allocable share" of the annual payments is a mere "0.4247591%." Pet. App. 4a. Furthermore, Montana courts have yet even to opine on whether Montana diligently enforced its Qualifying Statute. Whether Montana courts will decide that issue in a manner at all inconsistent with the arbitration panel considering other States' cases is accordingly pure speculation. In all events, as the Montana Supreme Court recognized, nothing would preclude a Montana court from applying any uniform diligent-enforcement standards announced in an arbitration proceeding. *See id.* at 19a.[13]

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[13] It also bears noting that this Court's review of the Montana Supreme Court's decision could not possibly prevent state courts from differing on the question of arbitrability of other issues under the MSA's arbitration provision in the future.

Second, the text and structure of the MSA flatly contradict the tobacco companies' assertion that state-by-state interpretation of the MSA is inconsistent with the parties' intentions. The tobacco companies knew full well the risk of disparate interpretations of the MSA in agreeing to a governing-law provision making the laws of each Settling State determinative. *See* MSA § VII(f); Pet. App. 18a-19a. Beyond that, as explained previously, the MSA gives state courts exclusive jurisdiction to implement, enforce, and interpret the MSA. *See* MSA § VII(a)(2); Pet. App. 8a. Indeed, in view of the governing-law provision, even the MSA arbitration panel will need to make state-by-state determinations of what constitutes "diligent" enforcement under the particular State's law. Petitioners' plea for uniform treatment, therefore, is inconsistent with the very contract they seek to arbitrate.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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April 26, 2010

PRICEWATERHOUSECOOPERS

March 7, 2006

Via Facsimile and Extranet

Re: Independent Auditor's Notice of Preliminary Calculations for the Tobacco Litigation Master Settlement Agreement Subsection IX(c)(1) Account Payments Due April 15, 2006 – NOTICE ID: 0185

Dear Notice Party:

PricewaterhouseCoopers LLP, in its capacity as Independent Auditor ("IA") to the Tobacco Litigation Master Settlement Agreement ("MSA"), provides the following information pursuant to subsection XI(d)(2) of the MSA:

- detailed preliminary calculations ("Preliminary Calculations") of the amount due from each Participating Manufacturer ("PM") (Attachment 1a) to be paid into the Subsection IX(c)(1) Account and setting forth all the information on which the Independent Auditor relied in preparing such Preliminary Calculations, and
- a statement of any information still required by the Independent Auditor to complete its calculations.

All capitalized terms used in this notice, unless otherwise defined herein, shall be defined as in the MSA. The information contained in this notice, including all attachments, is considered confidential and should not be used for any purpose other than as contemplated in the MSA.

Calculations

Data Source:

The Independent Auditor has used net volumes[1] provided by each PM and the Alcohol and Tobacco Tax and Trade Bureau ("TTB") to determine the individual Market Shares and the Total Market to calculate the payments due April 15, 2006 with respect to the Subsection IX(c)(1) Account.

The Independent Auditor is also in the process of verifying the accuracy of the domestic Cigarettes (excluding RYO) self-reported by the PMs.

The Independent Auditor obtained tax obligation data from the TTB for those PMs providing a Release to the TTB. From the obligation data, the Independent Auditor computed net Cigarette volumes as the sum of Lines 13, 18 and 20 from Form ATF F5000.24 divided by the tax rate. In many cases, this computed amount did not agree exactly with reported volumes. Therefore, the Independent Auditor requested PMs who reported net domestic Cigarette volumes to reconcile any differences from the net volumes reported to the Independent Auditor and the net volumes computed by the Independent Auditor based on data provided from the TTB. For purposes of this preliminary calculation, if a reconciliation was not provided by a PM that self-reported net volumes, the self-reported volumes were used for such PM.

Methodology:

The subsection IX(c)(1) payment is due from the Original Participating Manufacturers ("OPM") and

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[1] For domestic manufacturers, this would be the volume of cigarettes associated with the tax amounts reflected on Lines 13, 16 (RYO portion only), 18 and 20 on Form ATF F 5000.24.

from those Subsequent Participating Manufacturers ("SPM") that have payment obligations pursuant to subsection IX(i).

Calculations of Amounts Owing by OPMs:

The calculation for the OPMs is based on each OPM's Relative Market Share of the base amount of $8,000,000,000, subject to the allocations, offsets, reductions and adjustments listed in subsection IX(c)(1) and applied in the order set forth in clauses "First" through "Thirteenth" of subsection IX(j), as follows:

- "First", the Inflation Adjustment: Pursuant to Exhibit C of the MSA, the cumulative adjustment percentage in the year 2005 is calculated on Attachment 13.
- "Second", the Volume Adjustment: The calculation of the Volume Reduction for OPMs and SPMs, pursuant to Exhibit E of the MSA, is calculated on Attachment 3.
- "Third," the Previously Settled States Adjustment: Pursuant to subsection II(kk), the Previously Settled States Reduction is 12.45000% of the results of clause "Second."
- "Fourth," the Non-Settling States Reduction: As there are no states which have an Allocable Share of more than 0.0% that are not Settling States, clause "Fourth," the Non-Settling States Reduction, is not applicable to this calculation.
- "Fifth," Allocation Among Settling States: The allocation of the adjusted Base Payments among the States, pursuant to clause "Fifth," is shown on Attachment 9a.

- "Sixth," the NPM Adjustment: The Non Participating Manufacturer ("NPM") Adjustment, performed in accordance with subsection IX(d), is shown in Attachments 4a, 4b, 4c and 4d.
- "Seventh," Allocations: The allocation among the OPMs described in clause "Seventh" is reflected on Attachment 2 (with supporting calculations in Attachments 15 and 16) and the allocation among the States described in clause "Seventh" is reflected on Attachment 9a.
- "Eighth," Offset for Miscalculated or Disputed Payments, described in subsection XI(i): Various PMs have entered into settlement agreements with the Settling States related to NPM disputes from 1999-2002. The PMs with credits that are applied to this calculation are shown in Attachment 1c.
- "Ninth," the Federal Tobacco Legislation Offset,
- "Tenth," the Litigating Releasing Parties Offset,
- "Eleventh," the offsets for claims over pursuant in subsection XII(a)(4)(B),
- "Twelfth," the offsets for claims over pursuant in subsection XII(a)(8), and
- "Thirteenth," the aggregation of the payment obligations of each PM (Attachment 1a). As communicated to the Independent Auditor by the PMs, federal tobacco-related legislation has not been enacted and a claim-over offset and/or a Litigating Releasing Parties Offset, as described in subsections XII(a)(4)(B) and XII(a)(8), has not been sought. Thus, clauses "Ninth" through "Twelfth" are not applicable.

Calculations of Amounts Owing by SPMs:

The methodology for the calculation for the SPMs, is based on subsection IX(i) of the MSA.

1. Determination of the Existence of a Payment Obligation for Each SPM:

   Pursuant to subsection IX(i), each SPM's respective share of the total market was calculated for 1997, 1998 and 2005, and is shown on Attachment 5. In calculating each SPM's respective share, the Independent Auditor used the data provided by that SPM, subject to the data limitations described below within the section "Information Relied Upon".[2] The size of the total market in any given year is calculated on Attachment 8.

2. Determination of SPM Base Payment Amount:

   For each SPM from which payment is required, the adjusted Base Amount[3] is multiplied by the ratio of its Excess Market Share to the aggregate OPM 2005 Market Share. The result of this calculation determines the individual SPM's base payment amount, as shown on Attachment 6.

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[2] Two SPMs did not provide data as of the date of this calculation. FET data was available for one of those SPMs, indicating that no Cigarettes were sold; therefore, this SPM is assumed to have zero volumes. The volume for the second SPM was assumed to be zero

[3] The calculation of the SPM base payment due uses the initial base amount due from the OPMs adjusted by the Volume Adjustment, as calculated in clause "Second" of the OPM calculation, and is shown on Attachment 6 and in accordance with subsection IX(i)(2)

3. Allocations, Offsets, Reductions and Adjustments:

    1. The Final Calculation of the IX(c)(1) payment due April 15, 2005 (Notice ID: 0157) and IX(c)(1) 2000-2005 Consolidation of Amounts Due (Notice ID: 0170) indicated that some SPMs were in an overpayment status. Overpayments are credited to the next applicable payment; hence, April 15, 2006 payment obligations are reduced for these SPMs by the amount of the overpayment as of April 15, 2006 (see Attachment 1b).

    2. Various SPMs have entered into settlement agreements with the Settling States related to NPM disputes from 1999-2002. SPMs with credits to be applied to this calculation as a result of these settlement agreements are shown in Attachment 1c.

After making the applicable offsets, reductions and adjustments, the sum of the payments due from the SPMs is shown in Attachment 1a.

Information Relied Upon:

Most of the information relied upon in performing this calculation was supplied by the PMs and their representatives and a representative of the Settling States in response to the Independent Auditor's January 13, 2006 request for information (Notice ID: 0181). In addition, certain information was obtained from other sources to the extent that it was available. In summary, the information relied upon consisted of:

- Actual shipment volumes as reported to Management Sciences Associates, Inc. and supplied to

the Independent Auditor by each OPM for the year 2005;

- 2005 operating income data supplied to the Independent Auditor by each OPM;
- Revenue data from the sales of Cigarettes after FET taxes and after certain tobacco settlement payments supplied to the Independent Auditor by each OPM;
- 1997, 1998 and 2005 Federal Excise Tax ("FET") volumes supplied to the Independent Auditor by certain PMs;
- 1997, 1998 and 2005 FET obligations (converted to volumes by the Independent Auditor) for certain PMs supplied to the Independent Auditor by the TTB on February 23, 2006;
- Total Market volumes of Domestic Cigarettes based on FET supplied to the Independent Auditor by the TTB on February 23, 2006;
- Roll Your Own ("RYO") Released to Domestic Factories without Payment of Tax related to imports for the year 2005 as reported on Statistical Releases supplied to the Independent Auditor by the TTB on February 23, 2006;
- Imported Cigarettes and Imported Roll Your Own ("RYO") Total Market Volumes for the year 2005 as published in the U.S. Customs CD "U.S. Imports of Merchandise, Statistical Month – December 2005" and as reported to the Independent Auditor in correspondence.
- Arbitrios de cigarillos volumes for the year 2005 supplied to the Independent Auditor by certain PMs;

- Puerto Rican Taxing Authority arbitrios de cigarillos volume data supplied by the Puerto Rican Taxing Authority for 1997 and 1998 on March 1, 2002[4] and for 2005 on February 13, 2006;
- Total Market Volumes for 2005 Domestic RYO as reported on Statistical Releases supplied to the Independent Auditor by the TTB on February 23, 2006;
- Returns to Importers for Cigarettes and RYO supplied to the Independent Auditor by the TTB on February 23, 2006;
- Information from the National Association of Attorneys General related to the status of the Model Statutes enacted in the Settling States;
- Annual Consumer Price Index ("CPI") for all Urban Consumers as published by the Bureau of Labor Statistics;
- Where RYO data was provided in kilograms, a conversion factor of 2.2046226 kilograms per pound was used;
- Where data was provided in number of cartons, a conversion factor of 200 cigarettes per carton was used; and
- Where data was provided in number of cases, a conversion factor of 50 cartons per case, and 200 cigarettes per carton was used.

---

[4] An amendment to previously supplied Puerto Rico Taxing Authority data has not been received by the Independent Auditor as of the date of this notice. The Independent Auditor is currently working to resolve noted inconsistencies between data supplied by certain PMs and data supplied by the Puerto Rican Taxing Authority

Limitations:

The Independent Auditor encountered certain limitations with the data supplied. The data limitations are as follows:

- Not all PMs responded to the IX(c)(1) and IX(e) Information Request (Notice ID: 181) to provide their respective 2005 Cigarette or RYO volumes:
  - **Anderson Tobacco Co., LLC** – The Independent Auditor assumed 2005 volumes to be zero based on FET data supplied by the TTB on February 23, 2006.
  - **TAEBSA** – The Independent Auditor assumed 2005 volumes to be zero since this is a new SPM as of 2006 and no prior volume history has been provided by TAEBSA.
- Not all PMs that reported Domestic Cigarette volumes have provided a reconciliation between volumes reported to the Independent Auditor and volumes calculated by the Independent Auditor based on the FET data provided by the TTB.
- The Independent Auditor has received information request responses from some PMs denying that some Settling States have "continuously had a Qualifying Statute in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due [1999 – 2005], and diligently enforced the provisions of such statute during such entire calendar year" (subsection IX(d)(2)(B) of the MSA). The Settling States do not agree with this position. The Independent Auditor is not charged with the responsibility under the MSA of making a determination regarding this issue. More importantly,

the Independent Auditor is not qualified to make the legal determination as to whether any particular Settling State has "diligently enforced" its Qualifying Statute. Additionally, the Independent Auditor is aware of certain litigation that is ongoing related to this issue. Until such time as the parties resolve this issue or the issue is resolved by a trier of fact, the Independent Auditor will not modify its current approach to the calculation.

- Volumes provided by the Puerto Rican Taxing Authority for the years 1997, 1998 and 2005 do not appear to include the correct amount of Cigarettes sold in Puerto Rico and subject to arbitrios de cigarillos.
- Domestic RYO data for 1997 and 1998 is not available from the TTB.

Allocation of Payment to Beneficiaries:

All payments described herein will be credited to the Subsection IX(c)(1) Account and disbursed to the Settling States, all of which have achieved State Specific Finality. The Payments due from the PMs, as modified by the relevant Offsets, Reductions and Adjustments described above, are allocated among the Settling States based on each Settling State's Allocable Share (as stated in Exhibit A to the MSA). Based on the data available at this time, there is no reduction to a PM payment obligation resulting from the NPM Adjustment. The resulting allocations, including various adjustments, are shown on Attachment 1d.

Additional Information Required for Final Calculation

To perform the Final Calculation due no later than March 31, 2006, in accordance with subsection XI(a)(1) of the MSA, to the extent not previously provided or for which updated information becomes available, the Independent Auditor is requesting:

- If a PM has not responded fully to the IX(c) and IX(e) Information Request (Notice ID: 0181), please do so as soon as possible to the Independent Auditor;
- If a PM has additional information and/or modifications to its previous response relating to the IX(c) and IX(e) Information Request (Notice ID: 0181), please send the updates to the Independent Auditor as soon as possible.
- If a PM that has reported Domestic Cigarette volumes has not provided a reconciliation between volumes reported to the Independent Auditor and volumes calculated by the Independent Auditor based on the FET data provided by the TTB for 1997-2005, please do so as soon as possible to the Independent Auditor.
- Resolution of the question related to diligent enforcement of qualifying statues [*sic*].

In addition to the information requested from PMs above, the Independent Auditor will continue to follow up with the TTB, U.S. Customs, and the Puerto Rican taxing authority for additional updates to total market data.

Expected Disbursement

In addition, due to the volume of accounts involved in our disbursements, the Independent Auditor and the Escrow Agent request that the Settling States forward any changes in wiring instructions to the Independent Auditor as soon as they are known. Pursuant to Section 20 of the Escrow Agreement, "Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment." Any revisions received by the Independent Auditor after instructions have been sent to the Escrow Agent require a revised letter of instruction to the Escrow Agent and a secondary confirmation from the Independent Auditor. These subsequent letters and verifications due to revised wiring instructions delay the disbursement process. Therefore, at this time, the Independent Auditor requests any updates to wiring instructions that may have been made subsequent to the October 4, 2005 disbursement.

Disputes

Pursuant to subsection XI(d)(3) of the MSA, notice of a dispute relating to Preliminary Calculations must be delivered to all Notice Parties no less than 30 days prior (before March 16, 2006) to the Payment Due Date (April 15, 2006). Any notice that is sent to the Independent Auditor should be sent to the following address:

Independent Auditor to the Master Settlement Agreement
PricewaterhouseCoopers LLP
1201 Louisiana Street, Suite 2900
Houston, Texas 77002
Attn.: Ryan Harrell
Fax number: (713) 356-6000

***

This notice was sent via facsimile and Extranet on March 7, 2006. Authorized Users of the Tobacco Litigation Master Settlement Extranet may access this Notice and related Calculation on-line at http://www.tlmsa.net.

PricewaterhouseCoopers LLP

/s/ THEODORE F. MARTENS

By: Theodore F. Martens

Independent Auditor to the Master Settlement Agreement

Supreme Court, U.S.
FILED
MAY 10 2010
OFFICE OF THE CLERK

(3)

No. 09-911

IN THE

Supreme Court of the United States

R.J. REYNOLDS TOBACCO COMPANY, *ET AL.*,

Petitioners,

v.

STATE OF MONTANA *EX REL.* STEVE BULLOCK,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Montana

REPLY TO BRIEF IN OPPOSITION

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May 10, 2010

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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ARGUMENT

Montana opposes certiorari on three grounds. *First*, Montana argues that the interpretation of an arbitration provision is *solely* a matter of state law, and that the petition accordingly does not present a substantial federal question. *See* Opp. 10-16. *Second*, Montana argues that the Montana Supreme Court properly held that the nationwide tobacco Master Settlement Agreement (MSA) does not require arbitration of a dispute over "diligent enforcement," even though the courts of all 47 other States and Territories to have considered the issue have concluded just the opposite. *See id.* at 17-27. And *third*, Montana argues that the issues presented by this petition are not sufficiently important to warrant this Court's review. *See id.* at 27-32. As explained below, Montana is wrong on all three scores.

A. The FAA Creates Substantive Federal Arbitration Law, So The Interpretation Of An Arbitration Provision Is Not Solely A Matter Of State Law.

Montana first argues that "whether the parties agreed to arbitrate diligent enforcement is a matter of state contract, not federal arbitration, law." Opp. 10. Thus, according to Montana, this case does not implicate federal law—specifically, the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*—at all.

Montana is clearly wrong. As explained in the petition, it has been settled for almost half a century that the FAA establishes *substantive* federal arbitration law, *see, e.g.*, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967), and that this law governs in both federal and state

courts, *see, e.g. Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *see generally* Pet. 15. That substantive law addresses, among other things, whether the parties agreed to arbitrate a given dispute; indeed, this Court recently reaffirmed that "the central or 'primary' purpose of the FAA is to ensure that 'private agreements to arbitrate are enforced according to their terms.'" *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. __, __ (U.S. Apr. 27, 2010) (Slip op. 18) (quoting *Volt Info. Scis., Inc. v. Board of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989)).

Needless to say, the federal substantive right to enforce arbitration agreements according to their terms would be illusory if the interpretation of those agreements were *solely* a matter of state law. If that were so, state courts would be free (as the Montana Supreme Court did here) to defeat the federal right at will by invoking state law. Indeed, the federal substantive presumption in favor of arbitration (which Montana grudgingly acknowledges, *see* Opp. 11 (citing *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995)), would make no sense if the interpretation of an arbitration provision were *solely* a matter of state law.

That is why this Court has taken pains to emphasize that "the interpretation of an arbitration agreement is *generally* a matter of state law," as opposed to *exclusively* a matter of state law. *Stolt-Nielsen*, 130 S. Ct. at __ (Slip op. 17) (emphasis added); *see also Volt*, 489 U.S. at 474. While state law generally provides the background rules for interpreting an arbitration agreement, *federal* arbitration law "imposes certain rules of

fundamental importance" on the application of state law—including the rule that courts must "'give effect to the contractual rights and expectations of the parties.'" *Stolt-Nielsen*, 130 S. Ct. at __ (Slip op. 17, 18) (quoting *Volt*, 489 U.S. at 479); *see also id.* at __ (Slip op. 20) ("the purpose of the exercise" under the FAA is "to give effect to the intent of the parties").[1]

Thus, where, as here, courts refuse to "give effect" to the plain terms of an arbitration agreement, they violate the parties' *federal* arbitration rights. *See id.* at __ (Slip op. 18); *Southland*, 465 U.S. at 13-14. A state court cannot, consistent with the FAA, invoke state law to hold that an arbitration agreement does not mean what it clearly says. And a state court cannot evade review under the FAA by insisting that it is merely applying state law. *See, e.g., Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 446 (2006).[2]

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[1] As discussed below, while petitioners believe that the better course would be for this Court to resolve this case definitively itself, an alternative course would be to grant the petition, vacate the decision below, and remand in light of *Stolt-Nielsen*.

[2] There is nothing novel or unusual in this hybrid regime of federal and state law. For example, while state law generally governs the interpretation of contracts, the question whether a particular application of state law violates federal rights protected by the Contract Clause, U.S. Const. art. I § 10, raises a question of federal law. *See, e.g., General Motors Corp. v. Romein*, 503 U.S. 181, 187 (1992). Similarly, while state law generally governs the definition of property rights, the question whether a particular application of state law violates federal rights protected by the Takings Clause, U.S. Const. amend. V, also raises a question of federal law. *See, e.g., Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1031-32 (1992).

Montana nonetheless insists that "this case is on all fours with *Volt*," and that "*Volt* controls this case." Opp. 13-14. But *Volt* reaffirms the *federal* right to have arbitration agreements enforced "according to their terms." 489 U.S. at 478, 479. The state court in *Volt* did just that, *see id.*; the state court here did not. In addition, *Volt* confirms that the interpretation of an arbitration agreement is *not* solely a matter of state law, but that "due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." *Id.* at 476.

Indeed, if Montana were correct that "[r]esolution of th[e] threshold issue of the parties' intent [to arbitrate] is a matter of state, not federal, law," Opp. 12, this Court's recent decision in *Stolt-Nielsen* would be inexplicable. The Court there held, as a matter of *federal* substantive law under the FAA, that silence on the issue of class arbitration cannot be construed as consent to class arbitration. *See* 130 S. Ct. at __-__ (Slip op. 20-23). By contrast, under Montana's view, a state court would be free under state law to construe silence on the issue of class arbitration as consent to class arbitration, and *Stolt-Nielsen* would be a nullity.

Finally, Montana argues that the parties here contracted away their federal arbitration rights by agreeing in the MSA that "'[t]his Agreement ... shall be governed by the laws of the relevant Settling State.'" Opp. 13 (quoting MSA § XVIII(n)). As an initial matter, that argument ignores the MSA's arbitration clause, which specifies that arbitration "shall be governed by the United States Federal

Arbitration Act." MSA § XI(c), Pet. 7. In any event, a garden-variety contractual choice-of-law provision is not a waiver of federal arbitration rights. Were that so, the FAA would be essentially meaningless, since almost every contract includes a choice-of-law provision. Not surprisingly, therefore, this Court has consistently applied the FAA to contracts with provisions specifying that they are governed by a particular State's law. *See, e.g., Preston v. Ferrer*, 552 U.S. 346, 360-63 (2008); *Mastrobuono*, 514 U.S. at 63-64.

B. The Montana Supreme Court Violated The FAA By Refusing To Enforce The MSA's Arbitration Provision According To Its Terms.

Montana next strives to attach a fig leaf of respectability to the Montana Supreme Court's decision, contrary to the courts of the other 47 States and Territories that have addressed the issue, that a dispute over "diligent enforcement" does not fall within the MSA's arbitration provision. *See* Opp. 17-27. This effort too is unavailing.

At the broadest level, Montana asserts that the Montana Supreme Court could not have violated the FAA because nothing in the majority opinion expressly "*disavows* any federal policy or law." *Id.* at 18 (emphasis added); *see also id.* at 19-20, 21, 22. But it is hardly surprising that the Montana Supreme Court did not acknowledge that it was flouting federal arbitration law; courts rarely, if ever, acknowledge that they are flouting the law. Needless to say, the court "need not have said" that it was flouting federal law "to make it so." *Stolt-Nielsen*, 130 S. Ct. at __ n.7 (Slip op. 11 n.7).

On the merits, Montana has remarkably little to say. It simply repeats the Montana Supreme Court's manifestly erroneous assertion that a dispute over the Independent Auditor's presumption of "diligent enforcement" is not a dispute "'arising out of or relating to ... any determinations made by[] the Independent Auditor.'" Opp. 22-24 (quoting MSA § XI(c)). As every other court to address the issue has recognized, a legal presumption of diligent enforcement *is* a determination of diligent enforcement made on a categorical, as opposed to individualized, basis. *See, e.g.*, *Alabama v. Lorillard Tobacco Co.*, 1 So.3d 1, 11 (Ala. 2008); *New Hampshire v. Philip Morris USA, Inc.*, 927 A.2d 503, 510 (N.H. 2007); *North Dakota v. Philip Morris, Inc.*, 732 N.W.2d 720, 729 (N.D. 2007); *cf. American Hosp. Ass'n v. NLRB*, 499 U.S. 606, 611-12 (1991). At the very least, a presumption of diligent enforcement "relate[s] to" the Independent Auditor's determination not to apply the NPM Adjustment; after all, that presumption was the very *basis* of that determination. *See* Pet. 24 (citing cases).

And Montana does not even *try* to defend the Montana Supreme Court's decision to excise from the MSA's arbitration provision language requiring arbitration of, "without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)." Pet. App. 16-17a (quoting MSA § XI(c), Pet. 7). Rather, Montana simply repeats the Montana Supreme Court's Orwellian assertion that "reading the contract as a whole" requires reading this phrase out of the contract entirely, because it would "nullify the limiting words 'calculations

performed by, or any determinations made by, the Independent Auditor.'" Opp. 8 n.4 (quoting Pet. App. 16a). The parties included this language to underscore their intent to subject *all* disputes "concerning the operation or application" of the NPM Adjustment (set forth in MSA § IX(j), *see* Pet. 7) to binding nationwide arbitration. *See id.* at 25 (citing cases). By excising this language from the arbitration provision, the state court violated the FAA. *Cf. Stolt-Nielsen*, 130 S. Ct. at __-__ (Slip op. 17-23).

Montana's reliance on the MSA's provisions giving state courts "'exclusive jurisdiction for the purposes of implementing and enforcing this Agreement,'" Opp. 2, 4, 24, 32 (quoting MSA § VII(a)(2)), and authorizing the parties to sue in state court to enforce their rights under the MSA (or seek a declaration of those rights), *see* Opp. 2, 5, 24-25 (citing MSA § VII(c)), is equally unavailing. By their plain terms, both those provisions apply "*except* as provided in subsection[] ... XI(c)," the MSA's arbitration provision. MSA §§ VII(a)(3), VII(c)(1) (emphasis added). That limitation is not surprising: the arbitration provision would be meaningless if the parties were free to litigate disputes within its scope in state court. By agreeing that they could *enforce* their rights under the MSA in state court, the parties did not *relinquish* any such rights, including the right to arbitrate certain disputes under the FAA. *See, e.g., Nevada v. Philip Morris USA*, 199 P.3d 828, 833-34 (Nev. 2009); *Alabama*, 1 So.3d at 7-8 & n.7; *New Mexico v. American Tobacco Co.*, 194 P.3d 749, 752 (N.M. Ct. App. 2008); *Nebraska v. R.J. Reynolds Tobacco Co.*, 746 N.W.2d 672, 679-80 (Neb. 2008); *Massachusetts v. Philip Morris Inc.*, 864 N.E.2d 505,

512, 513-14 (Mass. 2007); *North Dakota*, 732 N.W.2d at 727.

Montana also errs by arguing that the Independent Auditor itself stated that it was "not qualified to make the legal determination as to whether any particular Settling State has 'diligently enforced' its Qualifying Statute." Opp. 4 (internal quotation omitted); *see also id.* at 23. As Montana acknowledges in a footnote, the Independent Auditor said that in a "preliminary" letter, and "removed that language" (after petitioners objected) from the final letter. Opp. 4-5 n.3. Indeed, the Independent Auditor itself referred the parties' dispute over the denial of the 2003 NPM Adjustment, based on the presumption of diligent enforcement, to arbitration. In any event, the Independent Auditor's assessment of its own competence has no bearing on the scope of the MSA's arbitration provision. Because a presumption of diligent enforcement is a determination of diligent enforcement, or at least related to such a determination, or at least related to the NPM Adjustment set forth in MSA § IX(j), this argument is a red herring. *See, e.g.*, *Maryland v. Philip Morris Inc.*, 944 A.2d 1167, 1178 n.14 (Md. Ct. Spec. App.), *cert. denied*, 949 A.2d 653 (Md. 2008); *Massachusetts*, 864 N.E.2d at 510 n.7.

Montana also errs by dismissing as irrelevant the decisions of other state courts holding that a dispute over diligent enforcement falls squarely within the scope of the MSA's arbitration provision. *See* Opp. 24-27. That otherwise unbroken line of authority underscores the central point of the petition: the Montana Supreme Court's contrary conclusion represents a failure to enforce the MSA's arbitration

provision according to its plain terms, which in turn represents a denial of the parties' federal arbitration rights. *See, e.g.*, *West Virginia v. American Tobacco Co.*, 681 S.E.2d 96, 112 (W. Va. 2009) ("plain and unambiguous terms"); *Nevada*, 199 P.3d at 833 ("clear language"); *Alabama*, 1 So.3d at 8 ("clear and unambiguous language"); *Illinois v. Lorillard Tobacco Co.*, 865 N.E.2d 546, 554 (Ill. App. Ct.) ("plain and unambiguous language"), *appeal denied*, 875 N.E.2d 1119 (Ill. 2007); *Louisiana v. Philip Morris, USA, Inc.*, 982 So.2d 296, 300 (La. Ct. App.) ("clear and explicit language"), *writ denied*, 992 So.2d 942 (La. 2008); *New York v. Philip Morris Inc.*, 838 N.Y.S.2d 460, 463 (2007) ("plain language"); *North Dakota*, 732 N.W.2d at 731 ("plain and unambiguous language").

This case thus presents the federal issue in the starkest possible manner: it is unlikely that this Court will soon again see an arbitration provision that has been uniformly construed by the courts of 47 States to encompass a particular dispute only to have the 48th State reach the opposite conclusion. If ever there were a case in which it is clear that a state court has denied the substantive federal right to enforce an arbitration provision according to its plain terms, *see, e.g.*, *Stolt-Nielsen*, 130 S. Ct. at __ (Slip op. 18), this is it.

C. This Petition Warrants This Court's Review.

Finally, Montana argues that this petition is not worthy of this Court's review. *See* Opp. 27-32. Again, that argument is incorrect.

Montana first argues that "the question presented is limited and case-specific." Opp. 27. But

that argument is based on the erroneous premise that the issue presented here is "a matter of Montana law," *id.* at 28, which it is not. Indeed, the fact that Montana feels free to argue that the interpretation of an arbitration provision is *solely* a matter of *state* law, notwithstanding this Court's ongoing reaffirmation of the *federal* substantive right to enforce arbitration agreements according to their terms, *see, e.g.*, *Stolt-Nielsen*, 130 S. Ct. at __ (Slip op. 18), only underscores the need for this Court's review.

Montana also argues that the decision below is of little practical effect, because no other state court has refused to enforce the MSA's arbitration provision, Montana is too small to matter, and the Montana courts may reach the right decision on the merits. *See* Opp. 31. But none of these arguments addresses the problem of how to implement the nationwide MSA if Montana courts and nationwide arbitrators apply different standards for diligent enforcement, or how to implement the MSA in the future if state courts may disregard the MSA's arbitration provision with impunity. This is, after all, a "landmark" agreement, *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001), with profound implications for the national economy and state budgets. It is hard to imagine a case where the need for national uniformity, and the countervailing pull toward parochialism, is more evident. There is a *Federal* Arbitration Act for a reason, *see, e.g.*, *Southland*, 465 U.S. at 13-14, and the Montana Supreme Court has made a mockery of all the other state courts that dutifully enforced the MSA's arbitration provision over the opposition of their States. *See* Pet. 19-23.

Montana also denies that its Supreme Court is waging a "war against arbitration," citing a single case in which that court (by a divided vote) enforced arbitration by applying the federal substantive rule of severability established in *Buckeye*, 546 U.S. at 443-45, and *Prima Paint*, 388 U.S. at 402-04. *See* Opp. 29. But one decision clearly compelled by federal law hardly overcomes a notorious record of hostility to federal arbitration rights. *See* Pet. 29-32 & nn.2, 3. Indeed, the decision below, rendered after the courts of 47 other States and Territories read the MSA to require arbitration, provides ample evidence that the "war against arbitration" in Montana is far from over. *See, e.g.*, Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139, 178 (2005).

Because the decision below cannot be reconciled with the federal arbitration rights reaffirmed most recently in *Stolt-Nielsen*, this Court may wish to consider granting the petition, vacating the Montana Supreme Court's decision, and remanding the case in light of *Stolt-Nielsen*. Petitioners submit, however, that the better course would be for this Court to grant the petition and resolve this dispute definitively, either by plenary consideration or summary reversal. Nothing in the decision below, the Montana Supreme Court's prior arbitration cases, or Montana's response to the petition suggests that petitioners have any possibility of vindicating their federal arbitration rights absent such resolution by this Court. *Cf. Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

CONCLUSION

For the foregoing reasons, and those set forth in the petition, this Court should grant the petition.

Respectfully submitted,

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